Economic Watch

United States

Friday, June 21, 2013

Economic Analysis

Boyd Nash-Stacey
boyd.stacey@bbvacompass.com

2012 State GDP Release

Broad-based growth brightens outlook

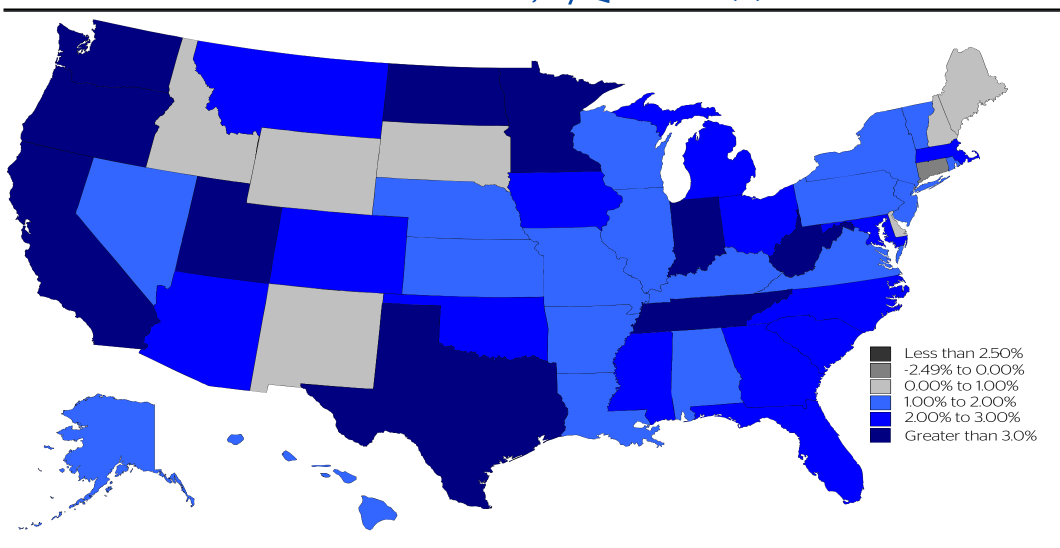
- **Manufacturing drives gains on the West Coast, contributing a combined total of 5.3pp to GDP growth in Washington, California and Oregon.**
- **Industry expansion in high growth states trickles-down to other sectors**
- **Growth likely to slow in 2013, rebound in 2014 and 2015**

For the first time since 2006 the overall outlook for state GDP is tilted to the upside. In 2012, U.S. state real GDP growth was positive in 49 out of the 50 states, and was only slightly negative (-0.1) in the only state that contracted, Connecticut. As expected, energy rich states such as Texas, North Dakota and West Virginia, on the heels of the shale gas revolution, grew at 4.8%, 13.4% and 3.2%, respectively. The west coast also outperformed the majority of the country growing 3.5% YoY, only surpassed by the Southwest. Growth also rose in the southeastern states and the plains area to 2.1% and 2.7% YoY, respectively. With greater growth homogeneity, the U.S. states grew 2.5% YoY in total.

In addition to reporting higher than expected growth in 2012, the BEA revised up growth in 35 states in 2011. For example, preliminary GDP estimates for Alabama suggested that 2011 GDP growth was negative, following positive growth in 2010. Now, however, the estimate indicates that Alabama activity has expanded for the past 3 years, which is in line with our synthetic GDP estimates. Other areas that were substantially revised up include South Dakota, Ohio and Hawaii, which grew 3.7pp, 2.6pp and 2.3pp more than originally estimated, respectively. In the case of Ohio, major contributions from durable and nondurable goods manufacturing brought up the states GDP from an initial estimate of 1.1% YoY to 2.9% YoY in 2012.

Chart 1

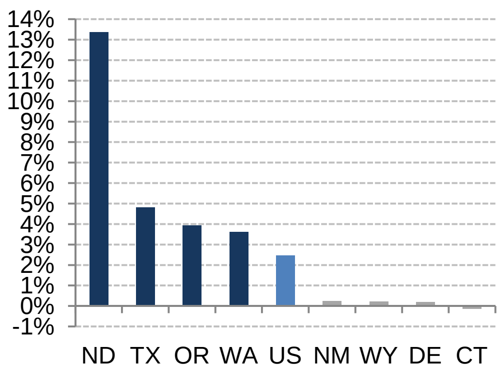
2012 Real Year-over-Year GDP Growth, By Quantiles (6)



Source: BBVA Research

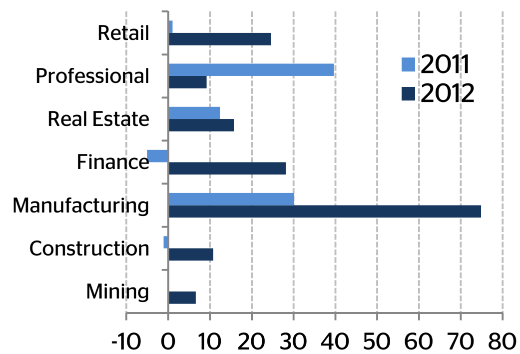
In Fifteen states, growth was revised down. The most striking revision occurred in Louisiana. Preliminary estimates for real GDP growth indicated that Louisiana grew positively in 2011. Major weakness in the nondurable goods manufacturing sector, which accounted for 14.7% of the states total output in 2011 strongly contributed to the states negative GDP growth. Of note, petroleum and coal products manufacturing and food and beverage declined 32% YoY and 10.4% YoY, respectively Similarly, West Virginia's manufacturing and construction industries were overestimated by $261Mil, reducing the 2011 preliminary estimate by 2.6pp.

Chart 2
2012 Real State GDP growth, (4 best and worst States)*



Source: BBVA Research & Haver Analytics
*YoY%

Chart 3
Contributions to US State GDP Growth, bp



Source: BBVA Research & Haver Analytics

Upside surprises in 2012, and better than expected recovery in 2011, reaffirms our baseline expectations for slow but positive growth over the recovery. Strong bifurcation at the onset of the recovery has given way to a more balanced growth environment. In essence, growth in states with greater concentrations of real estate losses and a less diverse industrial mix are now recovering. In addition, emerging headwinds are slowing the breakout pace of growth in a select group of states with a greater reliance on manufacturing and exports. Thus, assuming that global risks remain balanced, our expectation is for stronger growth convergence across states to begin in 2014.

Industry growth converges in 2012

Owing to a more uniform growth environment, four industry trends emerged in 2012. First, strong auto production and a bounce-back in consumer optimism drove the rebound in the durable-goods manufacturing sector. In total, manufacturing added 0.7pp to total growth, of which 0.6pp came from durable-goods sector. Second, adding 0.3pp to the U.S. state level growth, the first positive contribution since 2009, the financial service sector surged at the end of 2012. Elevated tax uncertainty at the end of 2013 caused risk-averse trading that increased the volume of financial transactions. Third, wholesale trade, a sign of increased business confidence, continued to trend positively adding 0.3pp to growth. And lastly, construction, which had been a considerable drag on the recovery, was a positive contributor to U.S. state growth for the first time since 2004.

The emergence of more diversified industry growth caused the gap to close between states heavily dependent on manufacturing and construction and those with higher value-added industries, such as mining and high-tech professional services. For example, Florida was able to take advantage a rebound in construction and strong contributions from the real estate, rental and leasing sector and ultimately grew at 2.7% YoY. Manufacturing, on the other hand, was largely responsible for the recovery in many of hardest hit areas of the country. In Alabama, the manufacturing sector accounted for 83% of the state's real GDP growth in 2012. Construction also trended positively in Alabama.

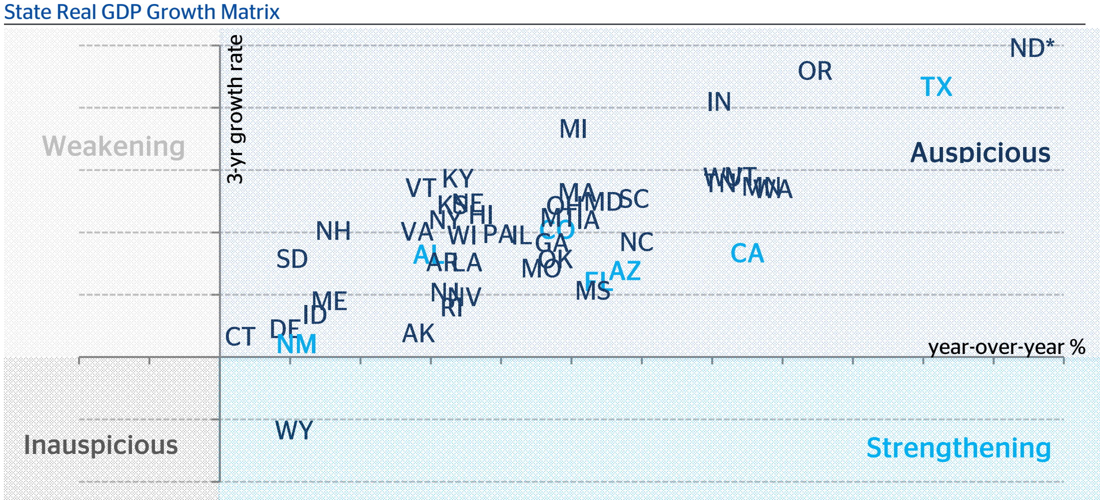
Table 1
2012 GDP Contributions to Growth & 2013 and 2014 Forecasts

	GDP Growth by State			Contributions to 2012 GDP Growth (pp)			
States	2012	2013*	2014*	Mining	Construct.	Manuf.	Real Estate
Alabama	1.2	1.2	1.5	-0.2	0.1	1.0	0.0
Arizona	2.6	2.4	3.6	-0.1	0.3	0.9	0.4
California	3.5	3.3	3.4	0.1	0.2	0.9	0.3
Colorado	2.1	3.0	2.8	-0.1	0.1	0.4	-0.1
Florida	2.4	2.8	3.1	0.0	0.0	0.3	0.7
New Dakota	13.4	6.7	7.8	3.0	1.3	0.8	1.1
New Mexico	0.2	0.5	1.2	-0.1	-0.1	0.7	-0.2
Nevada	1.5	2.1	2.8	0.1	-0.2	0.4	0.4
Oregon	3.9	3.4	4.7	0.0	0.1	4.2	-0.3
Tennessee	3.3	2.7	2.7	0.0	0.1	1.2	-0.1
Texas	4.8	4.2	3.4	1.0	0.4	1.0	0.2
U.S.	2.2	1.8	2.3	0.1	0.1	0.7	0.2

Source: BBVA Research
*Forecasts

Another more progressive phase of the recovery cycle is occurring in states with high concentrations of mining such as North Dakota and Texas. The combination of stronger employment gains, particularly in higher-wage occupations, and accommodative monetary policy are translating into greater impetus in the housing sector. Quantitatively speaking, the construction and real estate sectors contributed 3.0pp in 2012. In addition to the idiosyncratic growth trends within real estate and construction sectors, these states were also able to take advantage of the global growth environment that boosted the demand for durable goods. The positive effect from high income growth is also spilling over into service-based industries such as leisure and hospitality. As a result, these states are experiencing strong population growth which underscores our expectations for higher GDP growth.

Chart 4
State Real GDP Growth Matrix



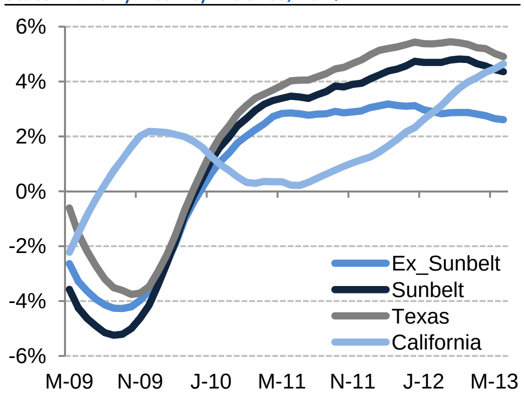
Source: BBVA Research
*ND scaled to fit: actual is 31.4% 3-yr growth and 13.4% YoY

On the West coast, a strong manufacturing sector buoyed the region's growth. For example, the Oregon manufacturing sector put in overtime, contributing more than 109% to the state's economic growth. California also got a big boost from manufacturing which accounted for nearly 1/3rd of the state's growth in 2012. As was the case in North Dakota and Texas, many of the states on the west coast saw employment gains concentrate in the high end of the wage distribution. In California, Texas, Colorado and Arizona, positively trending real income, ample supplies of housing and high affordability translated into an uptick in residential real estate markets. In Colorado, unlike other areas within the Sunbelt, growth was more diverse. For example, Information, professional scientific and technical services, retail and wholesale trade, and finance and insurance, each contributed 0.3pp to Colorado's growth.

Outlook

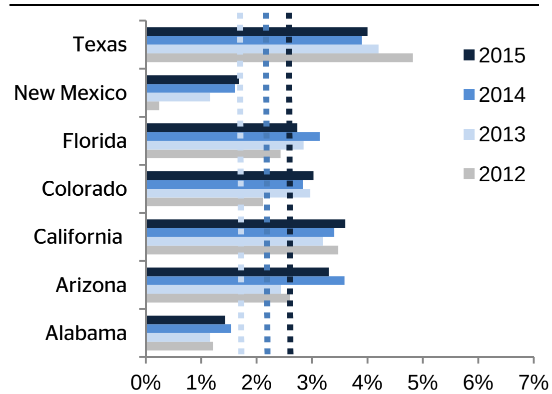
Going forward we expect the Sunbelt to contribute strongly to U.S. growth. A turnaround in California, underscored by an unparalleled high-tech cluster in Silicon Valley and high structural potential, greatly improves the overall outlook for the region. Furthermore, benefits from the technology shock to the oil and gas industry boosts our outlook for Texas. Combined, Texas and California, account for approximately 23% of U.S. GDP. Colorado is also forecasted to grow above the U.S. average. Gains in housing and favorable demographics suggest that Florida will continue to accelerate in 2013 and 2014. Growth in Arizona will depend on the pace of the housing market recovery, a sector which recovered quickly from recession lows.

Chart 5
State Monthly Activity Indexes, YoY%



Source: BBVA Research & Haver Analytics

Chart 6
GDP Forecasts(Dotted lines = U.S. forecast) , YoY%



Source: BBVA Research & Haver Analytics

Alabama and New Mexico, which are still recovering, will continue to experience soft GDP growth. Low population growth also dampens our outlook for these states. In addition, these states are more vulnerable to federal spending cutbacks which add to the downside risks in 2013. Nevertheless, growth should still exceed 1.0% for year.

While economic activity has hit somewhat of a lull in 2Q13, our medium-term outlook is much more optimistic. Global demand has slowed temporarily, but we expect that confidence will shift for both businesses and consumers as the year progresses and as idiosyncratic risks subside. Housing market improvements, relatively resilient consumption trends, and reduced policy uncertainty suggest a stronger boost from demand-side activity in 2H13. Our baseline forecast for 1.8% growth in 2013 assumes that the temporary slowdown will pave the way for increasing activity later in the year, with this stronger momentum carrying over to 2014 and 2015.