



Second Quarter – 2015

An independent economic analysis of Arkansas' three largest metro areas:

- Central Arkansas
- Northwest Arkansas
- The Fort Smith region

About The Compass

The Compass Report is managed by Talk Business & Politics. The Fort Smith analysis is sponsored by Arvest Bank. Economist Jeff Collins compiles the data and provides analysis.

REGIONAL SUMMARIES

Fort Smith region

The Compass Report for the Fort Smith area posted a C- grade for the second quarter, down from the B in the first quarter of 2015 and down from the C in the second quarter of 2014.

Fort Smith's metro economy was not able to build on gains seen in the first quarter. Although the region's jobless number declined (5.9% in June 2015, compared to 6.3% in June 2014), the number of jobs fell. Non-farm employment in the metro area peaked at 113,500 in the first quarter, but ended June at 112,600. That down from a second quarter 2014 peak of 113,600 and June 2014 at 113,300 jobs.

Northwest Arkansas

The pace of job growth, tax revenue gains and building activity produced a not surprising grade of B+ for the Northwest Arkansas economy during the second quarter. The grade was up from a B grade in the first quarter of 2015 and better than the B in the second quarter of 2014.

Nonfarm employment grew rapidly June-on-June. The metro economy added roughly 5,600 job, up 2.5%. Also, improved construction activity has translated into improved employment in the sector. Since the height of the recession when sector employment fell to a little more than 7,000 jobs, the sector has grown by approximately 20%.

Central Arkansas

Economic conditions in central Arkansas, the state's largest metro area, received a grade of C+ in the second quarter, unchanged from the first quarter of 2015 and better than the C in the second quarter of 2014.

Overall job gains, especially in the construction and tourism sectors, and stability in sales tax revenue helped the region to continue gains from the first quarter. There were 352,800 non-farm jobs in the region in June, ahead of the 346,700 in June 2014.

Regional "Takeaways"



FORT SMITH REGION

Nonfarm employment was down 0.6% June-on-June (700 new jobs), with total nonfarm employment an estimated 110,600 jobs in June compared to 113,300 in June 2014.

Comparing quarter-on-quarter data, nonfarm employment in the metro was essentially unchanged. This is in contrast to the first quarter of the year which indicated relatively strong nonfarm employment growth.

The June total number of employed in the MSA was an estimated 115,084. By contrast, total employment in June 2006, prior to the recession, was 125,426. Examining labor force data, there were 122,331 people either employed or looking for work in June 2015. By comparison, in June 2014, 120,340 people fit that description. This is an increase of roughly 1.7%.

June-to-June the manufacturing sector lost 300 jobs or roughly 1.7%. In June 2015 an estimated 17,800 people worked in the sector. Despite the decline, it appears employment in the sector has stabilized.

Despite the decline in nonfarm employment, two service sectors had increased employment June-to-June. Professional and business services (500) as well as other services (200) employment increased June-on-June.

Service sectors losing employment include: trade, transportation, and utilities (100), leisure and hospitality services (300), education and healthcare services (100), government services (100), and information services (100). In addition to the service sectors mentioned, natural resources, mining, and construction employment also declined (500). Financial services and information services were unchanged according to the data.

Residential construction as measured by number of permits and value was down significantly quarter-on-quarter (30% and 39% respectively).

Sales and use tax revenues, reported by the Arkansas Department of Finance and Administration, were down quarter-on-quarter 1.0 percent after adjusting for the increased rate in Crawford County. Collections were particularly strong in April.

Despite poor jobs data, the unemployment rate in the Fort Smith area June-on-June was down 0.3 percent. The reason for the decrease was a significant increase in the number of employed (2,268) relative to the increase in the labor force (1,991).

Data for the Fort Smith regional economy had been mixed for some time. The obvious conclusion is that the region has stabilized but there is no obvious source of growth which could change the current trend. Barring some unforeseen factor, look for the metro area economy to languish.

NORTHWEST ARKANSAS

Nonfarm employment grew rapidly June-on-June. The metro economy added roughly 5,600 jobs. This was an increase of 2.5%.

Looking at construction related data for the metro, the number of building permits in the second quarter for Northwest Arkansas were roughly 77% of the total for Q2 2014. However, the valuation of permits was 111% of Q2 2015.

Improved construction activity has translated into improved employment in the sector. Since the height of the recession when sector employment fell to just over 7,000 jobs, the sector has grown by approximately 20%. June-on-June the sector was unchanged despite strong permit activity and trend growth. Based on permit data the sector is likely to continue to add employment in the next two quarters.

Sectors that added jobs June-on-June were: trade, transportation, and utilities (2,000), professional and business services (1,300), education and health services (1,000), government (600), leisure and hospitality services (500), and financial services (200). No sector lost employment June-on-June. Three sectors were unchanged during the period: manufacturing, information services, and other services. Growth in education and health services was exceptionally strong growing at 4.2% June-on-June.

The unemployment rate in Northwest Arkansas was the lowest in the state amongst all MSAs in June (4.2%). The highest rate in the state was the Pine Bluff MSA at 8%. To add perspective, of the 387 MSAs in the country, only five posted rates above 10% while six had rates below 3%.

The labor force grew June-on-June in Northwest Arkansas by roughly 4.1%. By comparison, the labor force grew in Central Arkansas 2.9%. In the Fort Smith area the labor force grew a more modest 1.7%.

Sales and use tax collection data indicate that Bentonville, Fayetteville, Springdale, and Rogers have experienced solid growth quarter-on-quarter. In percentage terms, Rogers experienced the strongest growth in collections (8.3%) while Fayetteville collected the most tax dollars of any of the four major municipalities (\$10 million in the second quarter).

There is no reason to predict that growth will slow for the remainder of 2015.

CENTRAL ARKANSAS

The unemployment rate for Central Arkansas peaked in January 2011 at 8% but has improved since, estimated at 4.9% in June. Comparing to June of last year, the metro area unemployment rate has fallen 0.7%.

Nonfarm employment added 6,100 jobs or 1.8% since June 2014. By comparison, the Northwest Arkansas regional economy grew at a faster rate (2.5%) but added fewer new jobs (5,600). The Fort Smith regional economy lost roughly 700 jobs, or down 0.6% during the same period.

Government services and trade, transportation, and utilities comprise the two largest sectors of the Central Arkansas economy. June-on-June the two largest sectors were basically unchanged with only government services adding 400 jobs. Obviously trade, transportation, and utilities was unchanged during the period.

Other sectors gaining employment were natural resources, mining, and construction (2,500), leisure and hospitality services (1,200), education and health care services (1,000 jobs), manufacturing (300), financial services (300 jobs), other services (100), and information services (100). Professional and business services employment was also unchanged June-on-June. No sector lost employment based on the available data. The sector with the greatest percentage increase was natural resources, mining, and construction (15.5%).

Looking at the construction sector, building permit data revealed solid activity for the quarter. Expectations are the sector should add employment in the coming months but at a slower rate than Q2. Interestingly, despite the relatively larger size of the Central metro area, there were 214 fewer building permits issued than in the Northwest Arkansas metro (644 vs. 847). The difference was even more pronounced looking at permit valuation. The value of permits in the Central Arkansas metro was roughly \$86.6 million for the quarter versus \$200.7 million for Northwest Arkansas.

Comparing the most recent three month period to the same period for the previous year, sales and use tax data indicates that retail activity grew for the metro area by approximately 3.7%. The growth was led by Perry County. Collections were up quarter-on-quarter in all three major metros.

Most recent economic data for Central Arkansas continues to be encouraging. The local economy had struggled to gain momentum, particularly given weak growth in the government sector. The declining unemployment rate and growth in non-farm employment are positive signs the region is returning to trend. Given the size and over-all importance of the metro to state economic performance, a return to trend growth is very positive news for the state.

THE NATIONAL ECONOMY (April - June 2015 conditions)

Following weak GDP growth in the first quarter (0.6% change quarter-on-quarter) the economy rebounded in the second quarter. Output growth had been solid over the previous three quarters prior to the anemic growth recorded in the first quarter of the year. Second quarter results were the net of several competing factors. Consumer spending continued to benefit from lower commodity prices, however lower energy prices adversely impacted investment in the energy sector.

Meanwhile, the strong dollar and weak economic performance in many regions of the globe lowered demand for U.S. exports. Housing, which had been a major concern since coming out of the recession, seems to have fully recovered momentum based on sales data.

Finally, the Federal Reserve put an end its monetary stimulus through asset purchases, but concern for labor market performance and no imminent inflationary pressure will allow the Fed to maintain the current Fed Funds target of 0% to 0.25%. Additionally, the Fed has remained committed to reinvesting the principle payments back into treasuries and mortgage backed securities but this effort pales in comparison to previous stimulus policy. Most economists expect output growth to be solid if not spectacular through the end of the year.

The overall employment picture continues to improve. Nonfarm payroll employment added 692,000 in the second quarter, an average of roughly 230,666 per month. Over the last twelve months the economy has added an average of 213,000 jobs monthly, only falling below 200,000 jobs per month in March and April. The impact of consistent job creation is also evident in the jobless rate.

The unemployment rate has steadily declined since reaching a seasonally adjusted peak in October 2010 of 10%. The national unemployment rate for June was 5.3%. Despite improvement this is still above what most economists historically consider the “full employment” unemployment rate of 4%.

Consistent improvement in the national economy has impacted consumer confidence. The University of Michigan’s Consumer Sentiment Index has returned to levels not seen since January 2007.

Despite the persistently high unemployment rates, consumer spending has been relatively strong. Real retail and food service sales grew at an annualized rate of 1.7% in June. Again, lower energy prices have increased household buying power and should continue to through 2015.

The economic outlook is unlikely to be impacted significantly by governmental policy given the stalemate in Washington and the election season is in full swing, despite being more than a year away. Factors likely to have significant impact include reduced

monetary stimulus offset by lower commodity prices, rebounding labor and housing markets, and to a lesser degree weak economic performance in Europe and Asia.

Low oil prices are like a tax holiday for the consumer. Most industry analysts expect low prices to continue into the foreseeable future, particularly given slowing growth in China and weakness in the EU.

The strong dollar has made imports relatively cheaper, negatively impacting U.S. GDP growth.

Business investment had been one of the bright spots for the national economy. Although recent data indicate investment spending slowed during the first and second quarters, the outlook is for spending to accelerate through the second half of 2015.

Non-farm employment has grown for the last 19 quarters. The economy created roughly 692,000 non-farm jobs in the second quarter after creating 586,000 in the first quarter. Consumer demand continues to expand. Real personal consumption expenditures grew by 3.6% in the first quarter compared to an increase of 1.8% in the first quarter.

Federal government expenditures, which had been steadily declining rebounded modestly in the first half of the year. Employment growth at both the national and state level has been and will continue to be relatively strong in the services, particularly in hospitality, retail trade, professional and business services, and education and health care services.

Demand for housing has also rebounded due to latent demand, low mortgage interest rates, and renewed lending. With the memory of the recession still fresh in the minds of many, some markets appear over-heated. Absorption of new inventory needs to be closely monitored for signs these markets are over-built.

According to the Bureau of Labor Statistics, the Consumer Price Index increased at a seasonally annualized rate of 0.1% in June. The increase was driven by rising food, shelter, and new vehicle prices. The increase was partially offset by a large decrease in energy prices. The lack of inflationary pressure has allowed short and long-term interest rates to remain at or near historic lows. Short-term rates are expected to remain low for the foreseeable future as long as inflation remains below 2%.

Long-term interest rates remain low and have actually declined relative to rates at the end of 2013. For example, the 10-year Treasury Constant Maturity rate was below 2% throughout 2012 but had subsequently risen over time reaching 2.9% in December 2013. In June of this year the rate stood at 2.36%. Further propelling the housing recovery the 30-year Conventional Mortgage rate was below 4% for the same period until rising to a peak of roughly 4.4% in January. The rate has since retreated, standing at 3.98% in June.

Incomes and employment are expected to grow modestly through the remainder of 2015. Housing, however, is expected to continue to accelerate given positive market conditions.

RISKS TO THE U.S. ECONOMY

The U.S. economy remains heavily dependent on the consumer. Consumer confidence has improved significantly but international crisis could induce consumers to pull back. Globally, demand has softened impacting global output growth and demand for U.S. exports.

There are significant structural challenges to the Chinese economy which must be addressed to create stability and a sound basis for a return to growth.

The potential for Greek default and leaving the Euro Zone will negatively impact European economies and could induce additional defections.

While the unemployment rate has improved, it does not adequately tell the entire story. Reduced labor force participation, high unemployment rates for young and minority workers remain persistent problems.

Income growth remains modest despite improvements in the labor market.

The Federal Reserve has significantly reduced monetary stimulus in response to stabilized growth. However many economists are concerned about the impact on inflation of prolonged easy money.

Low oil prices are like a tax break, but how long will they last?