Broad based economic recovery continues in Houston, according to business executives responding to the October 1989 Houston Beige Book survey.

The survey indicates that consumer sentiment is positive and sales have increased as a result. Factory production remains high although growth in some industries has slowed, and only one industry reported an economic setback. Overall, the Houston economy is improving.

In particular, strong back-to-school sales, especially in apparel, reflect increased consumer demand. New car sales also continue to experience increased sales. Both these trends were anticipated by retailers and are expected to continue in 1990.

Production levels are also strong although growth has slowed in many local industries including refining, paper, machinery and metals. According to the survey, the only industry to report a setback was petrochemicals.

The Peoples Republic of China stopped buying polyethylene and polypropylene following the student demonstrations in Tiananmen Square, according to one respondent, significantly reducing the sale of these petrochemical products.

Overall, survey respondents have faith in the Houston economy and do not expect either a recession nor significant inflation in 1990. According to the survey, the outlook for prices is mixed with slight increases expected. Inventories are well within manageable levels and are expected to remain so.

The following is a brief overview of each industry according to the results of the September 1989 Houston Beige Book survey. The survey is conducted by the Houston Branch of the Federal Reserve Bank of Dallas and expresses the views of local business executives concerning the present and future business activity in the Houston area.

Retail Sales
Houston area merchants reported "fantastic" back-to-school sales. Total retail sales continued to grow as anticipated by retailers. Children's apparel sales spearheaded the gain, and school supplies also made a strong showing.

Consumer demand for all goods has been high, requiring only modest markdowns by retailers. As a result, inventories of summer merchandise cleared nicely, and inventory levels are now in balance with sales.

Automobile Sales
Automobile sales are also experiencing growth. Sales of new cars are running 6 to 7 percent ahead of levels a year ago.

According to respondents, there is no evidence that consumers are buying 1989 models in advance of the introductions of the 1990 models to avoid the announced 7 percent average price increases. Even so, dealers do not anticipate a sales slowdown in the new model year, due to large rebate incentives which will likely counter these price increases.

Commercial Real Estate
Leasing activity in the Houston area continues to strengthen. Occupancy of Class A office space has risen 10 percent since the beginning of the year. This increase has been, in part, at the expense of Class B and Class C office space. Respondents see the increase as a positive trend that will continue, although occupancy is still at half the level that was experienced in the early 1980s.

Leasing activity for retail space in upscale shopping malls is also strong in the Houston area. The tenants and potential buyers of retail space have improved as well.

These new tenants and potential buyers are more financially stable and represent better loan risks than those in the recent past. According to respondents, a few years ago bargain hunting attracted more poorly qualified buyers and tenants. The improved quality of these people represents a positive move for the market.

Drilling Activity
Domestic drilling activity has increased slightly in recent weeks due to seasonal demand, according to respondents. This increase is considered a good sign for the industry, although drilling activity still remains at its lowest level since 1942.

Most projects are by public companies, as small independent drillers are hampered by a lack of funding and burdened by the alternative minimum tax. Overall, even with the increase, the current rotary rig count is 6 percent.

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below the 1988 average, with natural gas wells now accounting for just over half of total drilling.

Drilling expectations for 1990 offer more room for optimism. A rise in rig count of 11 percent to a level of 975 rigs is forecast, according to respondents. Some of this increase is expected to reflect the shift of efforts by drilling companies from Canada to the continental United States. This is due to a recent change in Canadian legislation which reduces drilling incentives in that country.

**Oil Field Equipment**

Production of oil field equipment remains at a low level, and the most optimistic forecasts expect modest gains in 1990. One respondent would be satisfied if the trend remained flat as inventory levels are in balance with sales.

Respondents indicate prices for oil field equipment remain essentially unchanged, although increased competition for the larger jobs has reduced prices 3 to 5 percent, according to one respondent.

Some production costs for oil field equipment have gone down while others have increased. Overall, production costs have been reduced. This has improved profit margins at many firms.

In particular, aluminum prices are down substantially, but some equipment costs are inching up. Raw materials prices are a mixed bag, while the costs for air travel have increased significantly. Wage increases of 3 to 5 percent have also contributed to higher costs.

**Refined Products**

Demand for refined products has shifted from the summer gasoline market to winter fuel oils. Nevertheless, one respondent pointed to an upward trend in gasoline consumption and higher demands for jet fuels. These increases have helped bring inventories well in balance with market demand.

Price trends are mixed. The decline in crude prices has been reflected at the gasoline pump, while wholesale margins have been squeezed to a greater extent. Gasoline prices are beginning to rise on a seasonal basis.

Wage gains remain in check. This may change soon with the possibility of labor shortages in some job skill areas boosting pay scales.

**Petrochemicals**

Repression in China's Tiananmen Square put a dent in the sales of polyethylene and polypropylene, according to one respondent. Total production of these products is down 15 percent, and no increase is anticipated until next spring.

A fifth of the domestic output of these products is exported, although sales to China have stopped, and producers are trimming back production as a result of the loss. Polyethylene and polypropylene inventories have bulged in concert with the decline in sales. Prices have dropped 12 percent, and another 15 to 20 percent decline is expected.

Costs of production of these products have increased and are putting more pressure on profit margins.

**Paper Products**

Sales of paperboard containers remain stable, rising about 1 percent this year. Forecast for 1990 show respondents expect sales to remain essentially unchanged with some believing sales will increase slightly and others expecting a slight decline. The strength of future sales will depend, in part, on the value of the U.S. dollar since exports hold a significant share of the paper market.

Inventories of containers are "about right", according to respondents, although one firm noted a seasonal increase in advance of annual routine maintenance in its facilities.

Price increases in 1990 are forecast in the 2 to 4 percent range due to larger increases of input prices in chemicals, bearings and stainless steel. Wage gains for 1990 are expected to be less significant with no more than 3 percent anticipated.

**Steel Production**

Sales of Texas steel remain flat. The level of foreign competition remains unchanged, although steel imports are down a bit from a year ago. The voluntary restraint agreement is having no significant impact on domestic producers to increase capital investments.

Steel prices are mixed. Mills note some price declines, but users report increases. Production costs may increase as new labor contract negotiations place strong upward pressure on wages. High wage demands are based on past profits, but competition among producers is much keener at present. This creates an environment in which steel companies will not easily concede significantly higher wages.