HOUSTON BUSINESS BRIEFS

Freezing Cold Weather Disrupts Industry Output

Weather-related and other disruptions left much of the energy sector in disarray in early January, according to the January 1990 Houston Beige Book Survey conducted by the Houston Branch of the Federal Reserve Bank of Dallas. Freezing temperatures on the Gulf Coast, oil spills in New Jersey, navigation problems on the Mississippi, and freeze-related shortages throughout the nation interrupted distribution of oil products.

The arctic express that hit the nation at Christmas pushed up the price of heating oil and natural gas, and prices are expected to stay higher than normal until storage can be refilled against another outbreak of winter weather, according to respondents. Refineries and chemical plants throughout the Gulf Coast were forced to shut down because of severe temperatures, and normal operations were resumed in some cases only after 10 or more days. Refineries that normally produce larger amounts of gasoline this time of year for spring consumption shifted back to fuel oil. These disruptions in the energy industry are a setback for both sector and the region.

Beyond the energy sector, survey respondents indicate that the Houston economy continues to operate at a healthy level. Christmas sales in Houston were among the strongest in the nation, and numerous signs of skilled labor shortages are showing up in housing and manufacturing as activity in those areas increase.

Not all industries in Houston are doing as well, but the problems being experienced by these industries is occurring nationwide. Like the United States as a whole, auto sales in Houston are slow, and the manufacturing sector is not displaying the large, consistent monthly increases seen in 1987 and 1988. In spite of this, respondents indicate Houston's recovery is continuing.

The following is a brief overview of the January 1990 Houston Beige Book survey which expressed the views of Houston area business leaders concerning the present and future state of the Houston area. ❖

Paper Industry

Respondents reported a "good" increase in paper product sales in late 1989 following the slowdown experienced in the autumn months. Paperboard and linerboard manufacturers attributed the increase to customers moving inventory late in the fourth quarter.

Inventories at paper plants were reported to be in balance, and nonlabor costs are flat or rising slowly. In contrast, the tightening Houston labor market has increased turnover, especially among selected skills, causing upward pressure on wages.

Petrochemicals Industry

The petrochemical industry was hard hit by weather-related problems in late December, with some physical shutdowns continuing through the first week of January. The order books were described as "very confused." Going into the freeze, however, the industry apparently operated at a high level with no inventory problems.

The price of commodity chemicals fell throughout 1989 (ethylene by 33 percent for example), but prices are still at or above levels needed to justify replacement of existing plants. New plants and debottlenecking projects continue to be announced, but some concerns are being expressed by respondents about the volume of new capacity that will be produced by those plants both under construction and being planned.

Oil Services Industry

With the price of oil having moved up to the \$18-to-\$20 per barrel range for much of 1989, orders are running ahead of last year's level. Survey respondents expect orders will remain ahead of

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Where Is Houston Headed In 1990?

If you are a regular reader of the business pages, you know that a strong consensus has developed about the U.S. economy in the coming year: no recession, but slow growth with an increase in GNP of 2 percent or less. *Business Week* surveyed 50 economist to come up with a median forecast of a 2.1 percent GNP increase for 1990, and the *Wall Street Journal's* forecasting panel anticipates an average GNP increase of 1.6 percent.

What would such a forecast mean for Houston? Slow growth in the United States, in and of itself, is not the deciding factor in the city's prospects for 1990. This year Houston's growth depends on at least three other key variables -- oil prices, the price of petrochemicals and the value of the dollar on world markets. Together these factors have taken the Houston economy through some remarkable highs and lows in years past, but the immediate future will be positive and more sedate.

Houston has shared good times and bad with the oil industry, and most of the 1980s have been a time of retrenchment for both city and industry. In 1982, Houston found itself home to hundreds of oil-related projects based on expectations of oil prices of $50 per barrel, or more. When it became clear these prices were hopelessly unrealistic, Houston's oil boom of the 1970s became the oil bust of the 1980s. Between January 1982 and January 1987, the city lost over 100,000 energy sector jobs. In all sectors, over 200,000 jobs were lost. This represents a 12.8 percent reduction of the total workforce in Houston.

In spite of this, Houston remains a center for virtually every phase of the oil and gas business, much of it operating on a global scale. There are 66,000 workers in Houston's mining sector, almost all of them in oil and gas exploration and development. One-third of Houston's manufacturing jobs are in oil field machinery, refining or petrochemicals.

Since 1987, Houston's overall economic fortunes have turned once more, and economic expansion is robust and steady with 120,000 jobs now added to the workforce.
As Figure 1 indicates, most of Houston's new jobs have come in private services, and in some ways it represents a healthy diversification of Houston's economic base away from energy.

Figure 2 shows further detail of the private services sector. The tall bar marked "prof" (professional services) is made up of technical, medical, legal, educational and other professions. Nearly half of this increase in professional service jobs is made up of medical services and construction engineering jobs at firms such as Brown and Root, M.W. Kellogg, and Fluor Daniel.

It is also apparent from Figure 1 that the oil and gas industry -- Houston's most potent source of growth -- has contributed little to the current economic recovery. Mining, which is oil exploration and development in Houston, added only 4,400 new jobs since 1987, and manufacturing added only 15,000.

What Makes Houston Go?

A recent study completed by the Economic Department of the Houston Branch of the Federal Reserve Bank of Dallas looks carefully at three key factors that drive the Houston economy: the U. S. economy, oil and gas prices and the value of the dollar on world markets. (The values of these factors are tracked from 1987 to 1989 in Figure 3 shown on page 4) The complete study will appear in the March 1990 issue of the Dallas Fed's publication *Economic Review*, but a brief summary is presented here.

Figure 1
New Jobs Added in Houston Recovery
(Jan. 1987 to Oct. 1989)

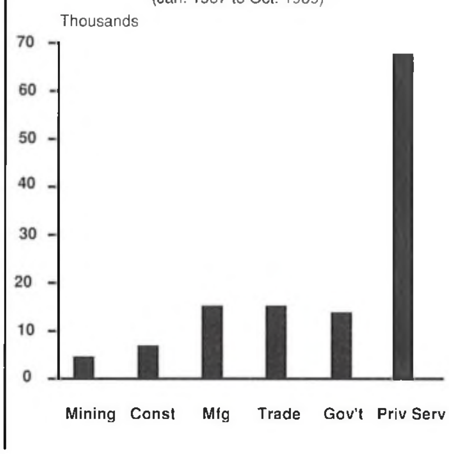
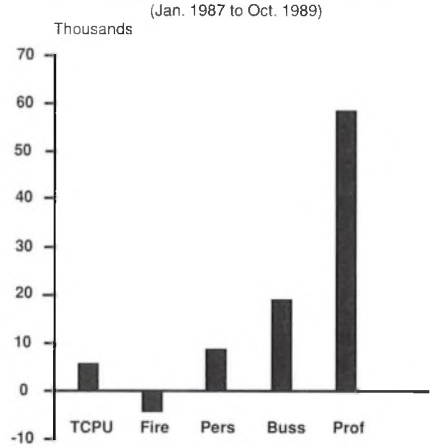


Figure 2
New Jobs Added in Private Services
(Jan. 1987 to Oct. 1989)



U. S. Economy -- There is a popular myth that Houston is immune to the effects of the U.S. business cycle. However, this belief simply confuses the effects of oil prices and the business cycle. Houston is affected by the business cycle in exactly the same way as the rest of Texas. In the past, rising oil prices have sometimes carried Houston through U.S. recessions. But, oil aside, Houston is helped by strong U.S. growth.

Oil Prices -- Houston's economy is much more sensitive to the price of oil and gas than the rest of Texas. This is no surprise. Much of Houston's manufacturing sector is tied directly to the search for oil and gas making it much more sensitive to oil and gas prices than the rest of the state.

Thus far in Houston's economic recovery, oil and gas prices have been a negative factor. In early 1987, oil prices stood at $15 per barrel in real 1982 dollars, but they fell to near $10 per barrel in 1988 recovering in mid-1989 to $15 per barrel. The drop in oil prices from 1987 to 1988, and its slow recovery, cost Houston approximately 20,000 jobs in mining and manufacturing.

Further, the effect of oil and gas prices on Houston's mining employment is now diminished in comparison to the years before the expansion began. An increase in oil prices that created 100 jobs prior to 1987 now creates only 60.

The Dollar -- Houston's economic base is hurt by a strong dollar and helped by a weak one. Houston is twice as sensitive to the dollar as the rest of the state, and this factor of two seems to hold up for mining, manufacturing and various energy-intensive industries.

One reason why the city is so greatly affected by swings in the value of the dollar on world markets is its strong international orientation. The port, the ship channel, 53 foreign banks, 514 foreign-owned firms, and a large consular corps all add to Houston's international connections and its sensitivity to dollar value shifts.

Petrochemical Expansion -- When looking at Houston's prospects for this year, we need to add to these results one more factor -- the boom in petrochemical plant expansion along the Texas Gulf Coast. This has been an important element of Houston's recovery because it added construction jobs as well as jobs at the big construction engineering firms in the city. Commodity chemical makers rode a major boom that began in 1988 as the price of their product soared. *Fortune* magazine reported this industry enjoyed 40 percent profits in 1988. This led to major planned expansions in capacity, and in the Houston area alone, 79 projects worth over $3 billion were announced by mid-1989.

During 1989, however, the price of ethylene (the largest petrochemical commodity) fell from 36 to 24 cents per pound. This was partly a result of slower economic conditions and partly due to new capacity. Some cancellations of Houston area projects are expected, and this important stimulus to the early phases of Houston's recovery seems likely to diminish in 1990.

This Year's Outlook -- If the apparent consensus for slower U.S. expansion is correct, and if we see a slowing of the recent petrochemical boom, Houston's economic expansion will slow down.

On the other hand, oil prices firmed up nicely in 1989 by moving to $18 to $20 per barrel in current dollars. The Baker-Hughes forecast for 1990 predicts a 7 percent increase in the number of operating rigs. This forecast also anticipates that more offshore drilling and deeper gas wells will improve business in the oil service industry. This would be a strong plus for Houston this year, should it occur.

Forecasting exchange rates is one of the most difficult assignments in economics. Last year the consensus supported a slow and steady fall in the value of the dollar. Instead, it rose sharply for the first three quarters before falling back to where it began in the fourth quarter. This year, the consensus seems to once more favor a falling dollar. Should this occur, Houston would strongly benefit.

In summary, Houston's continued recovery seems assured with continued U.S. expansion, steady oil prices and a weaker dollar. However, the strong growth seen in Houston from 1987 to mid-1989 may be threatened if the petrochemical expansion slows significantly or if oil prices do not remain stable at a level around $20 per barrel. Once more, Houston may need a solid performance from oil exploration in 1990 if strong growth is to remain on the agenda. ❖

Legend for Figure 2

TCPU-	Transportation, Communication, & Public Utilities
FIRE-	Finance, Insurance & Real Estate
Pers-	Personal Services
Buss-	Business Services
Prof-	Professional Services

last year's levels for the rest of 1990, with a solid increase in rig count over the year.

No labor problems in the oil services industry have materialized in Houston, although problems have been encountered in putting together drilling crews in West Texas. If the price of oil stays up, there will be pressure to make up for the wage freezes and cuts of the past few years.

Retail Sales Industry

This was an excellent December for Houston retailers, as the big stores in the larger Houston area malls were the biggest winners in Christmas shopping. Big department stores reported brisk holiday sales throughout the Southwest, with both Dallas and Houston leading the way with a 10- to 15- percent increase in sales over the 1988 holiday season. Competition was reported as "intense" in the Houston area, so lower margins may hurt profits despite the increase in volume.

Automotive Industry

The first three months of the year are typically slow for Houston auto dealers, and this year is no exception. A modest increase in sales materialized in January; however, this was not enough to offset the very slow pre-Christmas sales experienced.

Dealers expect the number of units sold in the Houston market in 1990 to increase, but last year's 7 percent increase may be difficult to match. Continued discounting has hurt dealer profits, and half of the area's dealers are operating at the breakeven point or below.

Real Estate Industry

One respondent described the Houston real estate market as "slightly over-hyped in all sectors," warning that improvement in this market has been slow and steady and will continue to be so. Expectations for near-term gains may be too high. Whatever the pace, gains are widely forecast for all segments of the Houston market in 1990.

Builders in Houston plan to construct 12,500 single family homes and 2,000 apartment units in 1990. This is a 20 percent increase over last year. This is significant considering Houston experienced a 37 percent increase in 1989. Land has been added to some of the largest and most desirable developments in Houston, but a shortage of developed lots in quality areas continues.

Strong upward price pressures will be evident in housing this year, as Houston's supply of construction workers tightens up. Shortages of such skilled workers as painters, framers and roofers are already materializing, and wages are rising.

The apartment market generally has turned around in Houston. Sales of luxury apartments inside the Loop are very strong at present, according to the survey respondents, with "an incredible amount of upgrading going on, and a substantial amount of construction."

In 1988, lender foreclosures ran 4000 to 7000 units per month in the city, but by late 1989, the rate fell under 1000 per month for the first time since 1986. The rate should fall much further next year as rents rise, cash flow improves for owners, and buyers become available for these units.

Office leasing chalked up a 4 million square feet gain in 1989. This is up from 3 million square feet in 1988. Occupancy rates in the central business district rose to 79.3 percent in the fourth quarter of 1989, up from 77.1 percent in late 1988. Comparable figures for the entire city of Houston were 73.3 percent and 68.9 percent respectively.

The pending sales of real estate by the Resolution Trust Corporation are expected to have only marginal effects on the overall real estate market. The holdings in Houston are largely comprised of fringe multi-family units, according to survey respondents, and their sale is not expected to hurt well-built, better located property. The single market that could suffer from these sales is the raw land in suburban/exurban locations. ❖

Figure 3 Dollar Value, Unemployment Rate and Oil Prices

(Quaterly, 1987 to 1989)