HOUSTON BUSINESS BRIEFS

Sources Of Recovery In The Houston Economy

The Houston economy continues to heal from the economic excesses of the early 1980s. Since January 1987, 40 percent of the new jobs created in Texas were in the Houston metropolitan area. Employment has averaged a 4-percent annual growth rate, nearly doubling the U.S. growth rate since 1987. Houston's unemployment rate fell from double-digit levels in early 1987 to 5.5 percent for the first three months of 1990. Local real estate and financial industries are now stable and are slowly improving.

Houston's problems stemmed largely from the loss of 100,000 jobs in oil exploration and oil services between 1982 and 1986. Indeed, Houston's challenge for the 1980s has been to grow when oil prices were depressed and new oil-related employment was very scarce. New employment in Houston since 1987 has stemmed from diverse sources that are difficult to identify, but this article addresses several possible sources.

Further, comparing sources of new growth to a listing of industries that contributed significantly to Houston's employment picture since 1987 enables us to draw some conclusions about the relative importance of these sources of recovery. This comparison indicates strongly that Houston has achieved growth in quality white-collar service-sector jobs and that oil—cheap oil for refining and chemical feedstocks—is central to Houston's recent strong growth.

Sources of Recovery

Tight Labor Markets— In 1987–88, for the first time in the decade, strong national and world growth materialized. As growth in gross national product (GNP) reached 4.4 percent in 1988, tight labor markets on the East and West Coast made Houston's surplus labor attractive to firms experiencing labor shortages. New jobs and new facilities shifted into Houston on the basis of labor availability.

Rising Commodity Prices— Expansion in 1987–88 also brought a broad recovery in commodity prices that were depressed for much of the preceding decade. (Oil was a notable exception to this recovery.)

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The Texas Gulf Coast depends heavily on agriculture, wood products, pulp, paper and some metals. This commodity base revived along with the world economy.

Decline in the International Value of the Dollar—The dollar appreciated by nearly 40 percent on world markets in the early 1980s and began to fall in 1985. Its return to levels closer to those of the late 1970s was an important precondition for Houston's recovery. Houston is a port city with 60 foreign banks and 600 foreign firms operating in the area. Changes in the value of the dollar are twice as important to Houston as to the rest of Texas.

Diversification From Oil—Although the role of diversification is easily overstated, it has influenced Houston's recent growth. Medical services are a frequently cited source of diversification, and expansion of the Texas Medical Center to 50,000 employees and 10,000 students in 1989 placed it at the heart of this growth. Similarly, the Johnson Space Center, as well as NASA's contractors associated with the Space Station Project, add to Houston's technical employment. Grumman, McDonnell Douglas and Rockwell are among the aerospace firms that have established a presence in Houston.

Cheap Oil for Feedstocks—In 1981–82, Houston was home to hundreds of projects based on the assumption that oil prices would reach $50 per barrel or more. When oil prices plunged instead, Houston's oil bust was under way. Thus, there is no small irony in benefit to Houston from cheap oil. However, Houston plays a crucial role in both the national refining and petrochemical industries. The Houston metropolitan area is home to 45 percent of the nation's petrochemical capacity (nearby Beaumont has another 11 percent); the Texas and Louisiana Gulf Coast house 40 percent of the national refining capacity.

Although both refining and petrochemicals have performed well in recent years, petrochemicals are the star of this recovery. Margins for ethylene—a key building block for plastics and synthetic rubber—averaged a very thin and unprofitable 4 cents to 5 cents per pound in the early 1980s; by 1988 this reached a very, very fat 40 cents per pound. Ethylene and other petrochemicals offered the kind of profit that invites expansion, and by mid-1989 some $3.2 billion in new construction was under way in the Houston area, plus much more worldwide. Engineering plans and studies were under way for another $5 billion to $6 billion in Houston alone, although it remains unclear how many of these plans will be carried out.

The petrochemical boom helped Houston by expanding local construction when office and other industrial construction activity was small or nonexistent. More important, however, Houston is a world center for the engineering and construction of refineries and petrochemical plants. Fluor Daniel, W.H. Kellogg and Bechtel, for example, design and build these facilities. As many as 5,000 new positions for energy engineers and technical support staff have opened in Houston since early 1987.

Legend

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

Figure 1
New Jobs Added in Houston Recovery
(Jan. 1987 to Dec. 1990)

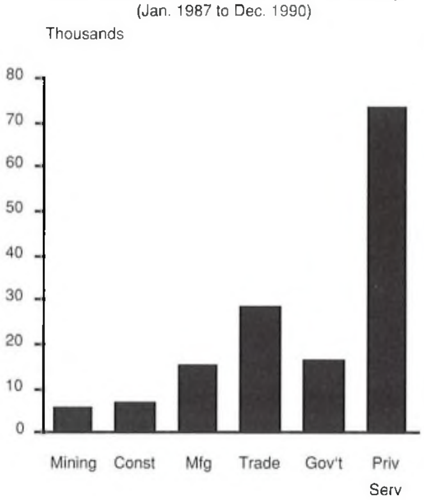
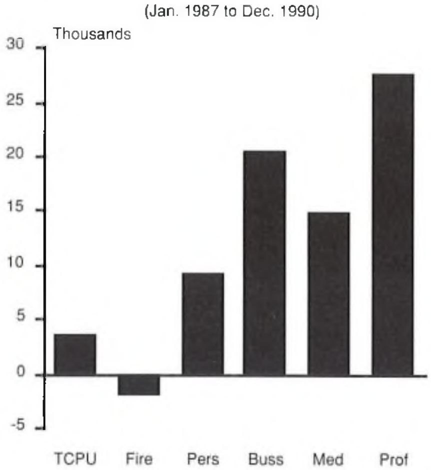


Figure 2
New Jobs Added in Private Services
(Jan. 1987 to Dec. 1990)



New employment in Houston

Figure 1 shows the net number of new nonagricultural wage and salary jobs created in the Houston metropolitan area since January 1987. The contribution was small in the mining and manufacturing sectors, which are affected by upstream oil operations in drilling and oil services. Construction employment, similarly, did not make a large contribution, but Houston was the only city in Texas to show a net gain in construction employment over this period. Trade expanded with the general economy; government expansion was not large. Private services stand out as the source of approximately half of Houston's job growth.

Figure 2 shows a breakdown of this private-service category. Transportation, communication and public utilities (TCPU); finance, insurance and real estate (FIRE); and personal services (PERS) such as dry cleaners, repair services and amusements, expanded with general economic conditions, as was also true for trade. The last three categories clearly made the largest contributions: business services (BUSS), medical services (MEDICAL) and professional services (PROF).

Business services, which grew rapidly throughout the United States, grew even faster in Houston. Houston's medical services sector, much of it housed at the Texas Medical Center, made a significant contribution to the city's recovery. Professional services, which consists of legal, educational, accounting, social services and, importantly for Houston, contain engineering and architectural services. Thus, professional services include a major contribution of the petrochemical expansion and perhaps some contribution as well from NASA and aerospace technicians.

Conclusion

As we look at Houston's expansion, nearly half the new jobs come from medical, business and professional services. These categories represent a wide variety in terms of job quality; but, if we look for those parts of the service sector where job quality maintains a high average, we find them in the medical, business and professional service sectors. Trade and personal services house those service-sector jobs often ridiculed as "hamburger flippers." Relatively high-paying, white-collar jobs in medical, engineering and other professional services have led the Houston expansion thus far.

This white-collar job growth may explain why the high-end of Houston's real estate market—West University, the Memorial area and the planned communities—was the first segment to recover. The recovery brought a very strong retail expansion in Houston, and this should correlate with the income gains these quality jobs generate.

Finally, while these numbers are not adequate to identify the role of the petrochemical boom in Houston, they are not inconsistent with the assumption that petrochemicals played a major role. If this assumption is true, Houston's expansion (or at least the current rapid pace of expansion) may be increasingly at risk after 1990. A slowdown in the demand for chemicals caused by a recession or a strong dollar or a glut in supply from the huge new capacity under construction will depress margins and halt engineering and construction work on many of these plants. How far would such a slowdown spread into retail, housing and real estate markets? A significant amount of leased warehouse space is tied up in petrochemicals, and some office space on short-term lease depends on continued engineering work.

These cautions aside, the new employment pattern stands in contrast to the early 1980s when new jobs poured into upstream oil. Diversification, even into downstream oil, ultimately contributes to the health and stability of the Houston economy. ❖

Houston Beige Book
April 1990 Results

Strong growth continues in Houston, and official statistics and our Beige Book respondents indicate continued healthy expansion. After three years of upward momentum, it is easy to forget that Houston is still well short of its 1981–82 employment levels. Beige Book respondents—particularly in construction, real estate, oil services and retail trade—often mention the softness or competitiveness in their markets. Compared to three years ago, Houston looks great now. This growth is not be confused, however, with a return to strong profitability in all industries. If the patient is not yet fully healed, Houston remains squarely on the path to recovery. A summary of April Beige Book responses follows.

Wholesale and Retail Trade

Easter sales were strong, and measured against last Easter, sales were up 8 percent to 10 percent. Retailers leave the spring season with their inventories in good shape. Aggressive purchasing is now under way for next fall, and retailers are pursuing ambitious plans. A large food wholesaler reports sales running 20 percent ahead of last year, and the next six months should continue to be strong. Auto sales in Houston are up 2 percent for the first three months of this year. This pace is a result of unseasonably warm weather, and the normal spring surge in sales may not materialize.

Oil Services

The number of Texas land rigs continues to climb, with horizontal drilling in the Austin Chalk leading the way. The increase in the number of horizontal rigs has imposed a waiting period for some measurement equipment, but with no price increases so far.

Real Estate

Rents continue to rise for Class-A office space, and the market is quite strong in selected parts of town. Despite discussion of new office construction in several areas in Houston, rents have not reached the replacement level yet. Some very large tenants might not be able to get the space desired without penalties, such as double rent. Only for this select group will new construction make sense.

Some signs of improvement at the bottom-end of the residential market are appearing finally as the effects of foreclosures wear off. The market for improved land—with infrastructure in place—is generating a lot of interest.

Chemicals and Refining

Sales and prices stabilized for refiners and bulk-commodity chemicals for most of the first quarter. Operating rates remain high, but oil prices that rose until early April hurt margins.

Metal and Machineries

Reports are mixed. Some companies have all the work they can handle, while other firms have little business.

Paper and Wood Products

Merchant pulp prices dropped sharply in recent weeks. This price decrease was blamed on increases in the value of the dollar—as prices are held fixed in terms of foreign currency—and on inventory adjustments by the Japanese. Sales of paper remain at a pace comparable to 1989, which one industry member termed "a very good year for us." Prices are down only slightly in some lines. Lumber sales are strong, and prices are rising. ❖

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