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# Houston Business

A Perspective on the Houston Economy

## Houston's Economy: Still Slow in 1994?

*Houston's prospects for 1994 are only slightly better than in the recent past. Weak oil prices, lingering cutbacks from the space station and pending health care reform will all slow Houston's economy in 1994; a strengthening national expansion and extensive refinery construction along the ship channel weigh on the positive side of the ledger.*

After 30 months without significant gains, Houston would welcome renewed employment growth in 1994. Between 1987 and 1991, the area experienced a dramatic recovery from the oil bust, restoring the 212,000 jobs lost during the energy downturn of the early 1980s and adding 45,000 more. But Houston's wage and salary employment turned flat in mid-1991, and since then growth has remained stagnant (*Figure 1*).

A disturbing aspect of the slow growth is the distribution of jobs losses. By October 1993, Houston had lost 16,700 jobs in oil and gas mining, manufacturing and construction; the economy remained on an even keel only by adding new jobs in services and local government. The replacement service-sector jobs too often were in low-wage, part-time jobs in bars, restaurants, and amusements.

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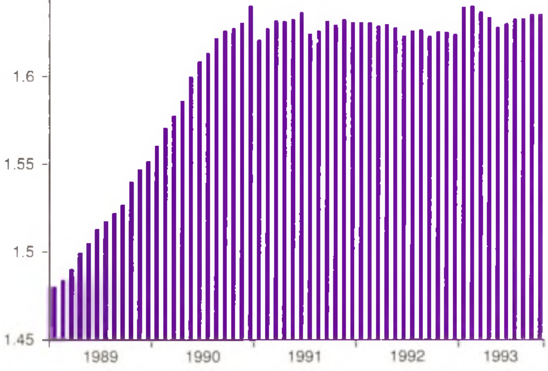
### WHY SO SLOW?

The 1991 slowdown began with another downturn in energy markets. During the Persian Gulf war, a number of local companies, especially oil service and machinery companies, built up staff in anticipation of a drilling boom for natural gas. Not only did this boom fail to materialize, gas prices fell to $1 per thousand cubic feet, and the Baker Hughes rig count fell to the lowest levels of its 50-year history. A wave of corporate restructuring hit local oil companies almost simultaneously, partly based on decisions to shift oil exploration to overseas markets. Producers perceive the U.S. onshore market as being drilled out, and Congress has limited offshore drilling to the western Gulf of Mexico.

Further, the national economy was providing little independent help to local job markets. The 1990–91 recession was one of the shortest and mildest of the past 50 years (*Figure 2*), and a national recovery was well under way by the time Houston's job market ground to a halt in mid-1991. But slowly expanding gross domestic product (GDP) added few new jobs for the first two years of recovery and expansion. There were many reasons for a slow and jobless national recovery: ongoing defense cuts, overbuilt commercial real estate markets, slow growth among our trading partners and restructuring and repositioning throughout corporate America.

By early 1993, Houston's economy should have turned around. Oil prices were favorable, natural gas prices were back to more than $2 per thousand cubic feet and the national economy was generating jobs again. Blocking progress, however, were several budget proposals from the new Clinton administration: a Btu tax that would have made the tax rate on oil more than double tax rates on other energy sources, a review of the space station project and health

***Figure 1***
**Total Houston Wage and Salary Employment, 1989 to 1993**




care reform. These proposals (whatever their individual merit) struck Houston repeatedly and very close to home. Not only did they hit the traditional oil base, they struck at the two centers of Houston's new-found diversity, the Texas Medical Center and the Johnson Space Center in Clear Lake. Projects were postponed or canceled at the Medical Center, in Clear Lake and along the ship channel.

Given these problems, perhaps Houston's flat performance hasn't been so bad. After all, the drilling downturn in 1982 cost the city 13 percent of its employment base. Over the past two years, Houston not only had another drilling downturn, but also slow national growth and a series of adverse federal proposals. The lack of speculative excesses in Houston, in contrast with 1982, served the city well in this period of slow growth. Houston has shown considerable resilience in the face of adversity.

## WHAT'S AHEAD IN 1994?

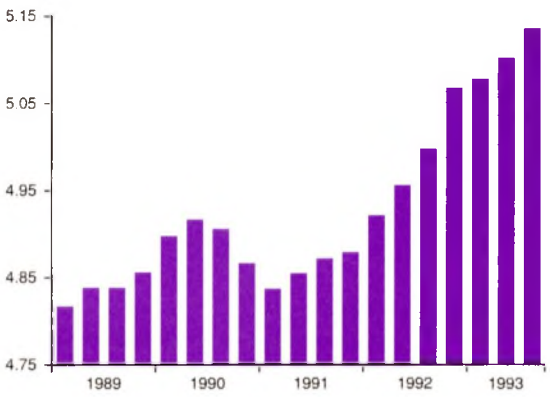
To appraise prospects for 1994, let's look at five key areas: oil and gas prices, construction along the ship channel, the U.S. economy, the Johnson Space Center and the Texas Medical Center.

**Oil and Natural Gas Prices.** As recently as this past October, the crude oil futures contract for January traded near $19 per barrel; in early December it moved under $15 per barrel. Weak global demand for oil and large supplies of oil from the former Soviet Union and the North Sea have driven prices downward. OPEC members are in compliance with production quotas developed just in November and have offered no further production cuts, in hopes that winter weather will pull prices back up. Oil is a substitute for natural gas in industrial and utility markets, and gas prices have followed oil prices downward. The January futures contract for gas was $2.35 per thousand cubic feet in mid-November and $2.05 in early December.

The outlook is for weak and volatile oil prices in 1994. If winter weather fails to bring prices up, OPEC will probably respond with further production cuts. The price of West Texas Intermediate should improve over the winter to $16 per barrel or higher and could average $17 to $18 for 1993. Iraq's potential return to oil markets will keep markets soft and volatile and keeps alive the risk of an oil-price collapse in 1994.

*Figure 2*
**U.S. Gross Domestic Product (Quarterly data)**

Trillions of constant 1987 dollars




SOURCE: U.S. Department of Commerce.

What happened to $2.50 prices for natural gas? Soft demand growth, higher storage volumes, imports from Canada and pressure from low oil prices are keeping gas prices weak. Warm winter weather could revive fears of a rerun of the 1992 gas price collapse. Prices for 1994 that average just over $2 are more widely forecast, however. Thus, both oil and gas prices will be at levels that offer modest incentives to drill and carry high (if temporary) downside risks for producers.

**Ship Channel Construction.** The demise of the proposed Btu tax was good news for refiners, and three large refinery construction projects have since been announced for the Houston area. Spending for just these three projects will total nearly $2 billion. The two largest projects will last three years and peak with perhaps 2,500 workers on each site; local engineering and construction firms also will benefit. The Clean Air Act continues to concentrate refinery facilities on the Gulf Coast as it closes small refineries across the country. There will be substantial capital spending in 1994 to bring facilities along the ship channel into compliance with the Clean Air Act. Other large projects may also be announced.

**The National Outlook.** In recent months, the national economy has moved into a higher gear. Data for October and November continue to indicate a very broadly based expansion finally taking hold, with strong consumer spending and rebuilding of business inventories. We should see GDP growth rates of 4 percent or more for the last quarter of 1993. Over 1993, nearly 2 million jobs were created by the national economy.

How much of this growth will carry to 1994? This recovery has showed promise before, only to have defense cutbacks, the credit crunch and other structural problems slow it down again. A large tax increase for many consumers will go into effect in early 1994, and it will dampen consumer spending. Lower long-term interest rates are providing a powerful and broad stimulus to the economy, however, and improved GDP growth should carry through all of 1993.

**The Space Station.** The Clinton review of the space station seemed to be resolved favorably this fall; Congress will continue the project under lower budget ceilings. However, recent efforts to bring the Russians into the space station program as partners has again brought turmoil to Clear Lake. The Russian role remains undetermined, the effect on local budgets unknown, the role of various contractors uncertain and funding is not being released until plans are solidified. The result is continued uncertainty and ongoing job attrition through 1994 for many associated with the space station.

**The Texas Medical Center.** This is another case where policy proposals threaten to slow Houston's recovery with uncertainty about one of the pillars of the Houston economy. To greatly oversimplify the issues, the concentration of specialists and advanced procedures at the Texas Medical Center epitomizes many of the problems the Clinton administration hopes to cure with health care reform. Alternatively, a network of primary care physicians would carefully screen patients and would be given far fewer incentives to refer patients to specialists. Delayed projects and staff reductions are already visible at the medical center; investors are scouring the city for local suburban hospitals that might benefit from the Clinton plan.

## CONCLUSION

For the state of Texas, employment growth should easily exceed 2 percent next year, while Houston's job gains will be closer to half that rate. Local job growth should accelerate slowly during 1994. Weak oil and gas prices and various federal policy changes present a significant risk for even slower growth or modest losses. Economic wheels turn slowly sometimes, and Houston remains at least a year away from stronger growth.

Conditions continue to improve slowly in Houston, with better retail, auto, and home sales. Both businesses and consumers appear cautious, however, as most markets remain fairly weak. Real estate markets are stable or improving. Sharply lower energy prices and weak drilling raise questions about the near-term stability of the energy sector.

## RETAIL SALES AND AUTOS

The holiday season began with moderate improvements over 1992 retail sales. Local retailers followed national trends with solid increases in big-ticket electronics and home furnishings. November generally was a good month, making up for a weak October. Holiday hiring picked up sharply as retailers saw improved November sales.

Of the four months leading into November, auto and truck sales logged 1992 levels only in October. November auto sales showed a 22-percent improvement over November 1992, and sales through the first eleven months are 2 percent ahead of last year. Truck and sport utility vehicles continue to lead the sales gains.

## OIL AND NATURAL GAS PRICES

The price of crude oil hit three-year lows—near $16.50—in mid-November, only to move to five-year lows—near $14.50—in early December. Through October, West Texas Intermediate had averaged less than $19 per barrel, or the lowest *real* price since 1976. Natural gas prices have followed the price of crude downward.

The domestic rig count has been flat and below 900 working rigs. The very strong seasonal increases typically seen in November simply failed to materialize. Machinery and oil service companies continue to report good revenues because the lucrative Gulf of Mexico remains very active and because of a rising rig count in foreign markets.

## DOWNSTREAM OPERATIONS

Refiners' margins have improved modestly in recent weeks, but they remain at historically low levels. Falling oil prices are often a positive influence on refiners' margins, but surplus capacity has driven product prices downward nearly as fast as oil prices. Over the Thanksgiving holiday, gasoline prices at the pump were 4 cents per gallon less than 1992 prices, despite an October 1993 increase of 4 cents per gallon in federal taxes.

The petrochemical industry reports strong product demand, and profits are growing in many segments of the industry. Supplies of ethylene and propylene remain seriously over capacity, and record volumes and record losses are piling up simultaneously.

## PAPER AND LUMBER

Lumber producers report strong demand and good prices, based on better national and regional markets for all construction products. Pulp and paper demand is rising for both boxes and paper products.

## CONSTRUCTION AND REAL ESTATE

Building permits for the city of Houston continue to lag 1992 activity; the value of all October 1993 permits was 6.9 percent less than October 1992 permits. For the first 10 months of 1993, the figures are even weaker, with residential construction off 3.3 percent and nonresidential off 6.7 percent. The overall 1993 figure, counting additions and alterations, lags the 1992 total by 10.4 percent.

New home sales jumped 10 percent this October, but starts fell 16 percent as builders decided to trim a three-month inventory of new homes. Existing home sales were flat compared to the same period last year, but the inventory of homes on the market is now down 10 percent compared to 1992. The apartment market remains flat, with rents barely keeping pace with inflation. Occupancy remains strong and near the highest levels of the past 10 years.

The Houston office market is stable, with occupancy down very slightly and rents flat. The downtown and Galleria markets remain slightly weaker than average, and the suburbs slightly stronger. Activity in industrial and retail markets remains subdued.

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