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Houston Business
A Perspective on the Houston Economy

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Houston Economy Heats Up

Almost exactly a decade after beginning its recovery from the oil bust, Houston is again enjoying a rapid expansion driven by energy and a strong U.S. economy. New jobs, tight labor markets, huge profits from energy, a housing boom, rising land prices and strong consumer demand combine to provide a buoyant economic atmosphere long missing from Houston.

Based on its timing, the recent acceleration in Houston's economy once again smells of oil, natural gas and petrochemicals. Back-to-back years of healthy oil and natural gas prices have rewarded a lean oil industry with tremendous profits. Houston, in turn, is seeing strong growth in oil services, durable manufacturing and a variety of business services.

HOW GOOD IS IT?

Since the U.S. expansion began in 1991, Houston has typically lagged statewide growth and especially that of rapidly growing metropolitan areas such as Austin and Dallas. In fact, job growth came to a near standstill from 1991 to 1993. Moderate job growth returned by 1994, but at a rate that still lagged the rest of the state. Finally, in 1997, it appears that Houston's growth has accelerated and is showing signs of robust health at every turn:

- Retail sales tax reimbursements by the Texas Comptroller to the City of Houston were up 7.8 percent in July over July 1996, and up 3.8 percent for the year to date.
- Harris County sales of autos and light trucks in May were 14 percent higher than those of the same month last year and 25 percent higher in June. The June auto sales were the best for that month since 1979.

- June sales of existing homes in Houston exceeded 4,000 for only the second month in the history of the city. The Multiple Listing Service inventory of existing homes has fallen to 30,000, the lowest level since 1982.
- New home sales in Houston were up 18 percent over last June's and were up 14 percent in the second quarter. Developed lots have become scarce, and prices are rising for land appropriate for housing development.
- The Houston office vacancy rate remains the fourth highest in the United States at 17.3 percent, with the U.S. average at 11.6 percent. However, over the first part of 1997, Houston has enjoyed some of the best improvement in the nation, with the vacancy rate dropping by 1.5 percentage points.

The estimates of employment growth in Houston continue to show only moderate gains, however. For the 12 months leading up to June, for example, Houston's wage and salary employment has increased by 2.1 percent. This performance matches the United States over the same period, but lags Texas by 2.5 percent. It also lags the state's fastest growing metropolitan areas of Laredo by 5.3 percent, Dallas by 4.1 percent and Fort Worth by 3.1 percent. There is good reason to believe, however, that the current estimates have understated Houston's growth since late last year.

When final revisions are made to 1996 estimates of employment growth, it will be based on administrative records (ES-202 data) that report the number of Houston employees covered by unemployment insurance. The raw ES-202 data for fourth quarter 1996 recently became available, giving us an early, rough look at future revisions. Table 1 compares the current estimate of the change in Houston's wage and salary employment from the third to fourth quarter, with ES-202 figures for the same period. Estimates are shown by major industry group, and the large increase in government employment reflects the return of teachers to school in the fall. The third column, which shows the difference between the figures, indicates that Houston's job growth in the fourth quarter was underestimated by 21,000 jobs—with over half the difference in the service sector. An additional 21,000 jobs would push Houston's job growth over 50,000 for the December 1995–96 period, or to 2.7 percent rather than the originally reported 1.7 percent. Since June 1996, job growth has probably been closer to 3 percent rather than the reported 2 percent. These revisions, when they are made, will affect the rest of Texas as well, pushing statewide growth in 1996 to about 3.3 percent from December 1995 to December 1996.

WHAT IS MAKING HOUSTON GO?

Last October, *Houston Business* reviewed the state of Houston's economy and noted that local growth was driven by a healthy oil industry and a strong national economy. This summer the story is unchanged except that oil and the national economy have both accelerated and moved to a higher level of performance, carrying Houston to a higher level as well.

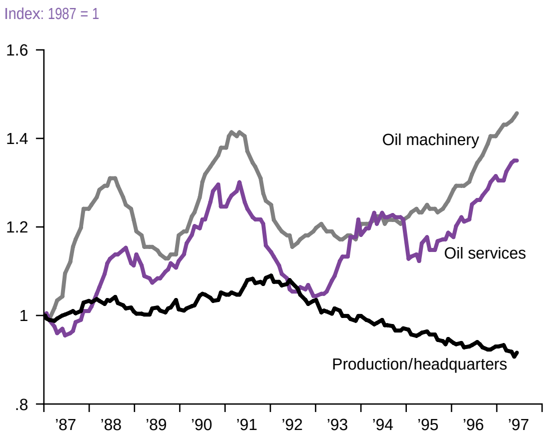
The national economy flows into Houston partly through the many companies headquartered here that operate in national markets, such as Compaq, American General, BFI and Continental Airlines. In addition, the U.S. business cycle is a major factor in the demand for refined oil products and petrochemicals. The national economy moved to a high level of performance in the second half of 1994, approaching full employment for the first time in the current U.S. expansion and moving to the highest levels of factory utilization since the 1970s. Quarter-to-quarter U.S. gross domestic product growth has alternately slowed and accelerated since 1994, but full employment of people and the factory system has remained a constant throughout the past three years. Even operating from such a high plateau, GDP growth accelerated to 3.8 percent late in 1996, then grew 5.9 percent in the first quarter of 1997. Growth will slow from this torrid pace

Table 1
Estimates of the Fourth Quarter Job Gain in Houston
Initial Estimates Compared to ES-202
(Change in the Number of Jobs, Q3 to Q4)

	Initial estimate	ES-202 data	Difference
Total	19,900	40,800	–20,900
Ag services	200	–600	800
Mining	400	500	–100
Construction	400	–100	500
Manufacturing	500	2,400	–1,900
TCPU	–500	1,900	–2,400
Trade	8,400	10,400	–2,000
FIRE	–600	500	–1,100
Services	–300	11,000	–11,300
Government	11,500	15,000	–3,500

NOTE: TCPU is transportation, communication and public utilities; FIRE is finance, insurance and real estate. Details may not sum to total due to rounding.

Figure 1
Houston Oil and Gas Employment by Sector, 1987–97



during the rest of 1997, but the national expansion should remain firmly in place for the coming year and continue to provide a healthy backdrop for Houston businesses.

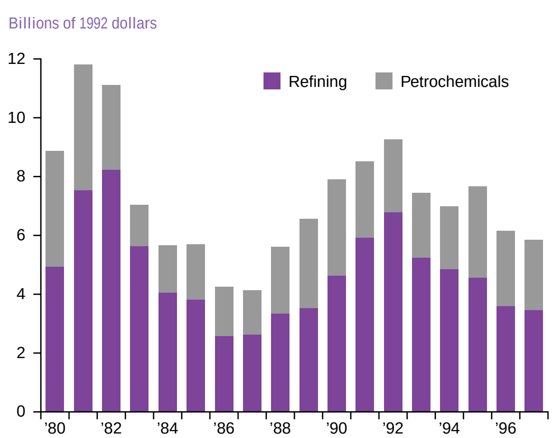
Oil and gas production, services and machinery accelerated sharply last year. After a decade of retrenchment, improved management and new technology have allowed this industry to cut costs, improve productivity and broaden the geophysical prospects available to it. The bottom line is a 40 percent reduction over the past five years in the cost of finding and developing a barrel of oil.

Today's oil producer can earn solid profits with oil at $16 per barrel or natural gas at $1.60 per thousand cubic feet. Fortune has smiled on the industry over the past two years, as weather-driven events and strong global demand have kept oil prices over $20 per barrel and natural gas prices over $2. The result has been tremendous profits for a lean industry, and huge cash flows have been available to reinvest in the industry. Shortages of oil field skilled labor and oil-related machinery have been severe. Figure 1 shows the sharp acceleration in Houston employment in oil services and machinery; this activity has broadly spilled over into other machinery, fabricated metal and much of the durable goods sector. In late 1996, the 12-month growth rates for Houston durable goods manufacturing were running higher than 8 percent.

Figure 1 also shows continued decline in the Houston large producer and oil headquarters employment base, despite higher profits. Improved industry management practices include substantial outsourcing for functions such as accounting, personnel, stockroom, secretarial and planning. Many of those who worked at large oil companies are now on the payroll of accounting, consulting or janitorial firms. As direct oil employment declines for producers or headquarters (shown in Figure 1), other oil linkages to the Houston business community may well be growing. The business services classification, which encompasses many of the local beneficiaries of outsourcing and downsizing, has grown rapidly in Houston since 1994.

Finally, support has come from Houston's huge refining and petrochemical complex as well; over 30,000 construction workers are currently involved in maintenance and new construction on the Houston Ship Channel. Figure 2 shows the domestic capital expenditures for the industry in recent years, much of which is spent on the Texas and Louisiana Gulf Coast. The overall slowdown in 1996 is largely attributable to the end of the push for refiners to comply with the Clean Air Act. However, petrochemical investment picked up in 1995 and 1996, as strong U.S. economic expansion began to push the chemical industry against capacity constraints. The 1997 investment levels projected by the industry early this year may now be too low. Vigorous U.S. growth has created solid profits for the petrochemical industry, and markets for plastics and synthetic rubber are growing strongly. Although capacity from the last round of expansion is just now coming on line, some segments of the industry are gearing up for more construction.

Figure 2
Domestic Capital Spending
On Refining and Petrochemicals, 1980–97



NOTE: 1997 is projected by the companies surveyed.

SOURCE: *Oil & Gas Journal*, Annual Capital Spending issue.

Economic growth in the Houston metropolitan economy has accelerated, with recent levels of home and auto sales now rivaling those of the boom years of the early 1980s. Houston added 13,400 jobs in May—45 percent of the total for Texas metropolitan areas—and divided most of the state's metropolitan job growth with Dallas in June. Employment security records have recently become available for late 1996—data that will be used to revise the 1996 employment estimates for Houston. These figures indicate that Houston's job growth was significantly understated late last year, and could be understated through early 1997.

RETAIL AND AUTO SALES

Overall retail sales are reported to be strong, although a changing retail market has produced some soft spots and competitive sectors. Retailers are hiring, but the current tight labor force is generating problems with turnover and the quality of job candidates.

Auto and truck sales in Harris County soared in both May and June. The May figures were up 14 percent over a year ago, and the June figures were up 25 percent. Whereas U.S. auto sales were down slightly, the year-to-date Houston auto sales were up 9 percent. Manufacturer incentives helped increase sales in a strong Houston market.

ENERGY PRICES AND OIL EXPLORATION

Crude oil markets traded with a general undertone of weakness; early June inventories stood at a two-year high, and NYMEX futures prices hit a 16-month low near $19 per barrel. Prices moved mostly on political news from the Middle East or on news from the quarterly OPEC meeting. Incentives from the futures markets contributed partly to the buildup in oil inventories, with spot prices below future months.

Natural gas prices remained stable near $2 per thousand cubic feet. Inventories depleted by a cold spring continued to provide support for prices. And a heat wave in the Midwest and Southeast briefly pushed prices up over $2.20 as utilities scrambled to generate electric power for air conditioning loads.

Despite weaker oil prices, oil service and machinery companies continue to report strong demand, shortages of oil field goods and skills, and growing lead times.

GASOLINE PRICES AND REFINING

Refineries completed their turnarounds in late spring and, to take advantage of strong margins, began producing gasoline at or near maximum capacity. A slow start to the summer driving season combined with these high production levels to push wholesale prices down and to erode refiners' margins as well. These margins have slipped steadily in recent weeks.

Gasoline inventories built up throughout the period, again because of incentives from the futures market. The driving season seemed to strengthen in July as the demand for gasoline improved.

PETROCHEMICALS

Base petrochemical markets saw stable product and feedstock prices in recent weeks. Expectations of lower ethylene prices on the Houston Ship Channel temporarily evaporated after an explosion at the Shell Deer Park refinery. New ethylene capacity coming on line over the summer was expected to weaken the market soon and give customers a choice of suppliers. The loss of the Shell production tightened up the market temporarily, although no price increases were reported. Price declines are expected, with new capacity still coming, leaving the timing of future price reductions only partly dependent on Shell's return to market.

HOUSING AND REAL ESTATE

A new office building in Fort Bend County, where the office occupancy rate is 98 percent, is now under construction. Several other office projects are being proposed for Fort Bend, another for Montgomery County and three for the Katy Freeway in west Houston. Several new office buildings are in the works, including headquarters for Compaq and BMC Software.

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