FEDERAL RESERVE BANK OF DALLAS HOUSTON BRANCH December 1999

Houston Business
A Perspective on the Houston Economy

Texas Employment on the Uptick

The best characterization of the regional economy is that it is shaking off many of the adverse effects of the Asian financial crisis. We now see rising exports; improvement in oil, chemicals and agriculture; and moderating construction activity as interest rates rise.

Texas' job picture continues to show strength, with third-quarter private employment expanding at a 3 percent annual rate—double that of the United States. Perhaps the best characterization of the regional economy right now is that it is shaking off many of the adverse effects of the Asian financial crisis. Asia and its aftermath cut into exports; hurt commodity-driven sectors in agriculture, chemicals and oil; and helped interest-sensitive sectors as rates fell to artificially low levels. We now see rising exports; improvement in oil, chemicals and agriculture; and moderating construction activity as interest rates rise. This article takes a closer look at recent economic developments across the state.

JOBS DATA SHOW STRONG GROWTH

The complicated and continuing process of revising past data always leaves us reassessing not only where we are going, but also where we have been. Revised first-quarter 1999 employment data show that Texas slowed more than previously thought. Rather than the 3 percent annual rate of private employment growth initially estimated, we now find first-quarter growth was only 1.4 percent.

Table 1 shows that in the rebenchmarked first quarter, mining (mostly oil and gas extraction in Texas) and manufacturing were a large and growing drag on Texas job growth, and private services slowed substantially. A 10.7 percent growth rate for construction employment kept the overall figures from dipping into the negative. The services sector slowdown was exaggerated by a large

Table 1
Texas Private Employment Growth by Industry
(Annual rates of change)

	Total	Mining	Manu-facturing	Con-struction	Private services
1998					
Q2	3.3	–4.8	2.6	8.3	3.6
Q3	3.7	–8.5	2.7	7.1	4.2
Q4	3.9	–13.1	–2.9	9.4	5.0
1999					
Q1	1.4	–18.9	–4.9	10.7	2.1
Q2	2.8	–13.6	.4	2.8	4.0
Q3	3.0	2.5	1.3	5.4	3.2

SOURCE: Texas Workforce Commission; author's calculations.

decline in home health-care workers and physical therapists, the result of Medicare's cutoff in payments for many of these services after the first of the year.

Third-quarter data show a broad reassertion of strength in all Texas economic sectors, with job growth returning to a 3 percent annual rate. The resurgence stems from the return of oil and gas extraction, as mining employment grew at a 2.5 percent rate. Manufacturing moved up to a 1.3 percent rate, and all other sectors grew at better than 3 percent (*Table 1*).

Table 2 looks at the first-quarter slowdown and subsequent reacceleration in private employment growth in Texas' six largest metro areas, as well as the remaining 27 percent of state private employment outside these metro areas. The slowdown was widely shared across the state, with only the I-35 corridor sustaining significant job growth: Dallas, at 3.2 percent annually; Fort Worth, 4.1 percent; and Austin, 7.5 percent. Houston and El Paso were at a standstill, and the rest of Texas was losing jobs.

Why did the central I-35 corridor hold up? These metro areas are the most sensitive in Texas to the U.S. economy because of their transportation, finance and wholesaling links. Thus, they felt the positive shock from U.S. growth most strongly. Austin and Dallas are particularly close to the high-tech boom and the investment in computer-related equipment that has shaped the current U.S. expansion. Meanwhile, low oil prices hurt Houston, and San Antonio and El Paso suffered from their close ties to Mexico as global financial volatility spread into Latin America.

In the third quarter Texas job growth rebounded to a 3 percent annual rate, double the 1.5 percent in the United States. Data in Table 2 also show a broad geographic reassertion of third-quarter Texas economic growth, with all metro areas sharing in the expansion.

CONSTRUCTION SLOWS

Figure 1 shows falling residential and nonresidential construction, offset by surging nonbuilding construction activity to keep statewide construction level. Single-family housing has flattened out across the state as mortgage rates moved up. Although state homebuilding has hit a normal seasonal lull, current slow sales in Houston and Dallas are more than normal seasonal events. For 2000, a 25 percent drop in homebuilding looms for Dallas, along with a milder 10 percent to 15 percent decline for Houston.

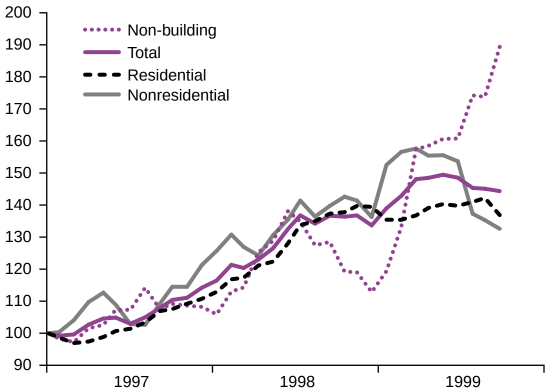
After several years of rapid growth, the state's metro areas are catching up on roads, schools and other infrastructure needs. Houston's list of such projects is long: $678 million for school construction, $177 million for downtown streets and sidewalks, $400 million per year for highways, $378 million for a new football stadium, $1.4 billion in airport improvements. Other Texas metro areas have similar lists. The result has been a surge in such construction, which is generally less sensitive to rising interest rates than private building.

Table 2
Texas Private Employment Growth by Major Metro Area
(Annual rates of change)

	Texas	Dallas	Fort Worth	Houston	San Antonio	El Paso	Austin	Rest of Texas
1998								
Q2	3.3	5.3	3.8	4.0	3.1	1.4	6.2	3.2
Q3	3.7	4.5	4.0	4.9	5.2	.2	6.1	1.7
Q4	3.9	4.5	2.9	3.4	3.5	2.5	4.2	4.2
1999								
Q1	1.4	3.2	4.1	0	1.9	.4	7.5	–.7
Q2	2.8	3.3	4.2	2.1	5.0	4.7	7.5	1.0
Q3	3.0	2.5	5.3	2.5	3.2	3.1	4.6	2.4

SOURCE: Texas Workforce Commission; author's calculations.

Figure 1
Construction Activity Remains Stable



SOURCE: F. W. Dodge; author's calculations.

OLD AND NEW TEXAS ECONOMIES BOUNCE BACK

The Asian financial crisis hurt both the "old" commodity-driven Texas economy of oil, chemicals and agriculture and the "new" telecommunications and semiconductor economy. Both have now bounced back.

High-technology companies are doing very well. Memory chip demand is soaring, and prices have climbed 25 percent in recent months. Heightened demand is linked to higher inventories being held in the wake of the Taiwanese earthquake—essentially recognizing country-specific risk associated with semiconductor suppliers. PC demand for chips is healthy, but telecommunications is the major driver for current orders. As cellular phones get more sophisticated, they require more chips per unit. Dallas, Fort Worth and Austin are the primary beneficiaries of this business in Texas.

Signaling a return of the "old" regional economy, Texas exports bounced back in the second quarter with a 6.1 percent increase. The state registered higher exports of electronics, transportation equipment and chemicals. After several declining quarters, industrial machinery exports leveled off, probably because shipments of oil-related machinery bottomed out.

Beige Book contacts in the Texas chemical industry reported excellent export demand growth in the third quarter. Chemicals were among the first regional industries to be hurt by declining shipments to Asia. Now products such as ethylene, polypropylene and polyvinyl chloride (PVC) are experiencing excellent increases in foreign demand, especially from Asia.

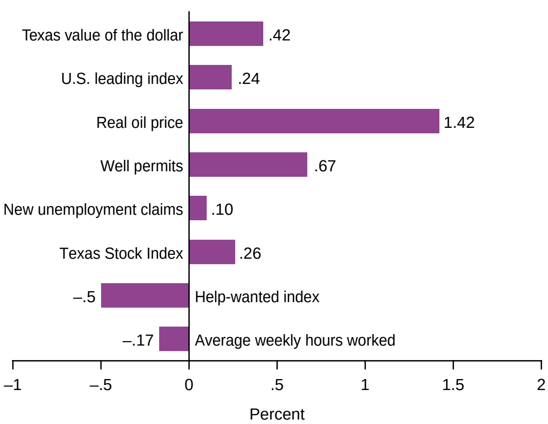
The oil rebound remains tentative, despite a 60 percent increase in statewide drilling since the April trough. The work available to oil service companies has not risen in proportion to the rig count, however; major oil service companies continue to report flat earnings and selective layoffs. While oil and natural gas producers are more active, they are unwilling to undertake large, expensive or risky projects. The domestic drilling increase in recent months remains shallow, vertical and land-based, using as few resources as possible. A basic distrust of OPEC seems to be at the root of the conservative increase in drilling, since nearly all the new domestic drilling activity has been directed to natural gas and not oil.

Outside the United States and Canada, the international rig count continues to fall. A typical foreign rig will bring two to 10 times the revenue of rigs making up the current increase in domestic drilling activity, as the foreign rigs are far more likely to be remote, deep, directional, offshore and technology-intensive.

CONCLUSION

Last year at this time the Texas leading indicators had declined five months in a row, an event without parallel since the Texas recession of the mid-1980s. Every indicator except the U.S. economy was pointing downward. This year most indicators are pointing strongly upward (*Figure 2*). Even if second-quarter employment data are revised downward to reflect lingering weakness—a good bet—all the fundamentals seem to have fallen into place in the third quarter.

Figure 2
Leading Indicators Components, March – August 1999



Houston seems to be putting the effects of low oil prices behind it, although the recovery in oil and chemicals remains tentative. Local job growth in mining and manufacturing is turning positive, and the Houston Purchasing Managers Index also points to turnaround and slow expansion in oil extraction and manufacturing. If confidence can be developed that high oil prices are sustainable, Houston could hop on the fast track for job growth in 2000.

RETAIL AND AUTO SALES

Retail sales softened in October and November, but the long, warm autumn was generally blamed for the slower sales. A good cold snap and some winter weather are needed to get customers excited about what is now on display. Home furnishings continue to be the star of the retail sector.

Houston auto sales in October were flat compared with last year, but October 1998 set a very strong record. Year-to-date sales are still 3.4 percent ahead of last year, and dealers confirm that sales continue strong into November.

CRUDE AND OIL PRODUCT PRICES

Crude oil prices continued to climb in November, surging to over $25 per barrel on news of continued OPEC compliance with its objective to remove 4.3 million barrels per day from world markets. The price of heating oil and gasoline both followed the price of crude upward, but not by the full amount of the crude price increase. The result was that refiners' profit margins, already quite weak, were pushed down even further. Texas and Louisiana refiners responded to poor demand and weak margins by cutting back production to less than 90 percent of capacity.

OIL SERVICES AND MACHINERY

The drilling response to higher crude prices over the last six weeks was a healthy additional 56 rigs put to work—a 7.5 percent increase. However, the increase in oil service work remains less than proportional to the rig increase. The additional drilling has mostly been onshore, shallow and vertical, using relatively few resources. Oil-directed drilling has been about the minimum to maintain existing properties and drill expiring leases; 49 of the 56 additional rigs were directed to natural gas.

PETROCHEMICALS

Petrochemical product prices continued to rise in October, with some products able to recover the increased cost of energy feedstocks and add to profit margins. Additional margin was lost, however, with the November oil price run-up. Short-term profits in the chemical industry will remain critically dependent on winter weather; cold temperatures will raise feedstock prices and hurt profits. Demand for petrochemicals remains extremely strong, with Asian requirements adding to powerful domestic growth.

REAL ESTATE

About 4 million square feet of office space is expected to come online this year in Houston, about on trend for the past five years. Rents and rentals are reported flat, with continued concern about the possible effects of big oil mergers still hanging over the office market. For retail space, occupancy and rents are both up, a product of conservative development over the last year.

Multifamily apartment traffic is down, and rents are stable in new projects. Rents in existing apartment projects are falling, as owners try to hold onto their tenants in an overbuilt market. New home sales have softened over the last few months. This is partly a seasonal phenomenon, but lagging job growth and higher interest rates share the blame. Existing home sales in October reached record levels despite very low inventory.

For more information, contact Bill Gilmer at (713) 652-1546 or bill.gilmer@dal.frb.org.

For a copy of this publication, write to Bill Gilmer, Houston Branch, Federal Reserve Bank of Dallas, P.O. Box 2578, Houston, TX 77252.

This publication is available on the Internet at www.dallasfed.org.