



Houston Business

A Perspective on the Houston Economy

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Economic Insight from Gulf Coast Neighbors

Our neighboring cities of Beaumont, Port Arthur and Orange (BPAO) are close enough to Houston and share enough similar features—a history built on oil exploration, a port on the Gulf of Mexico, a common refining and petrochemical complex—that looking at the BPAO economy from Houston is like looking in the mirror. But important lessons can be learned from the reflected image, because the external forces that move through BPAO often differ from those that affect Houston. The effect of specific events may be more easily recognized in BPAO than in a larger, more complex metro area like Houston. And the factors that set BPAO apart from Houston and the rest of the Texas Gulf Coast carry invaluable economic insight as well.

THE BPAO ECONOMY

Table 1 shows the 1999 percentage distribution of private wage and salary employment in BPAO, comparing it with Houston and other upper Texas Gulf Coast metro areas.

Even though Beaumont, as home of the 1901 Spindletop discovery, is the birthplace of Texas oil, local oil extraction employment today is not big enough to bring its share of mining employment up to the state average. BPAO enjoyed a flurry of activity and job creation in 1997–98, with renewed high levels of activity in the Gulf of Mexico, but this momentum was lost with the 1998 downturn in oil prices.

In 1999, construction and manufacturing clearly set BPAO apart from Texas and other Gulf Coast cities. The share of employment devoted to

construction was nearly twice the state average, even given the high levels of building taking place throughout Texas last year.

The share of jobs devoted to manufacturing is similarly much larger than in the state or other Texas Gulf Coast cities. The difference is most pronounced in nondurables, with refining and petrochemicals largely defining and dominating this sector.

Durable manufacturing maintains a significant presence in BPAO, another legacy of the history of oil exploration and production in southeast Texas. Even as oil exploration has moved elsewhere, basic metal bending and production of pumps, valves, motors and other machinery remain fundamental building blocks of the local economy. It is here that a downturn in domestic or worldwide oil prices and exploration is first felt.

Within the transportation, communications and public utilities sector (TCPU), the most important economic activity occurs at the local ports. Beaumont, Port Arthur and Orange each operate a port, and port activity is best seen as a complement to the local refining and chemical industries.

The economy of upper Texas Gulf Coast metropolitan areas slowed significantly last year, with a combined December-to-December metro job growth of only 1.1 percent, following 3.6 percent in 1998. Because the region is still built on commodities—oil, chemicals, agriculture—the combination of a loss of chemical and agricultural exports to Asia, plus

a collapse in oil prices, finally took its toll in 1999. BPAO fully shared in the slowdown, with 1 percent job growth, down from 2.6 percent the year before. Houston slipped to 1.5 percent in 1999 from 4 percent in 1998. The other four metro areas in the region saw employment fall by a combined 0.9 percent.

The unemployment rate in BPAO remains stubbornly high, in spite of solid job growth through much of the late 1990s. At 8.3 percent in 1999, it was highest among the metro areas on the upper Texas Gulf Coast, down from a decade high of 11.2 percent in 1993 but up from 7.2 percent in 1998. Houston, in contrast, averaged 4.5 percent in 1999, while Texas averaged 4.6 percent. At least two factors lie behind the high rate. First, an unemployment rate of 15.9 percent exists among the BPAO minority population, a group that makes up 51.8 percent of the local workforce. Second, major swings in economic activity in BPAO are often driven by petrochemical construction. This temporary chemical construction work requires skilled labor that is often provided by a migratory workforce from Houston, Lake Charles or other Gulf Coast metro areas, not from the local labor pool.

RECENT TRENDS

Many of the most visible trends shaping the BPAO economy in recent years will be familiar as features common to Houston and other Texas cities: construction of big box retail outlets; growth of call centers for credit cards and medical billing; cinema complexes at the malls; new hotels and motels such as Comfort Inn, Holiday Inn Express and Fairfield Inn; and pervasive road and highway construction. Corporate mergers have created a dizzying series of local name changes, as what were once the flagship refineries of Gulf, Texaco and Mobil now belong to Clark, Motiva and Exxon Mobil, respectively. The local Baptist Hospital System recently became the property of Memorial Hermann.

Tourism, recreation and retirement provide another important recent economic theme in southeast Texas, as the region tries to capitalize on its natural resources—birding at High Island, a new visitor center for the Big Thicket and fishing tournaments at Lake Rayburn and Toledo Bend Reservoir. Port Arthur's 18-mile-long Pleasure Island was a U.S. Corps of Engineers spoil site for material dredged from the

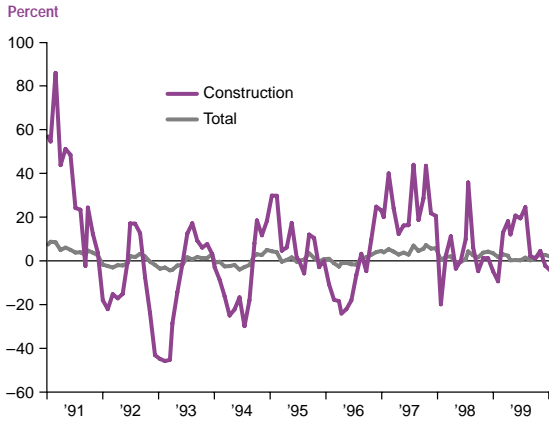
Table 1
1999 Distribution of Private Nonagricultural
Wage and Salary Jobs
(Percentages)

	BPAO	Houston	Other Texas Gulf Coast	Texas
Mining	0.6	3.6	2.0	2.0
Construction	13.3	8.4	10.7	6.7
Manufacturing	18.4	11.9	13.9	14.3
Durables	7.4	7.2	4.6	8.8
Nondurables	11.1	4.8	9.2	5.5
TCPU	5.9	8.4	5.5	7.3
Wholesale trade	3.9	7.4	4.5	7.0
Retail trade	23.5	18.9	24.7	21.7
FIRE	3.8	6.4	5.6	6.7
Services	30.6	35.0	33.0	34.1

NOTE: FIRE is finance, insurance and real estate; TCPU is transportation, communications and public utilities; Other Texas Gulf Coast cities are Brazoria, Corpus Christi, Galveston–Texas City and Victoria.

SOURCE: Texas Workforce Commission and author's calculations.

Figure 1
Growth of Construction and Total Employment in BPAO



SOURCE: Texas Workforce Commission and author's calculations.

local ship channel in the early 1900s. The island is now easily accessible by bridge, home to the Walter Umphrey State Park, and a focal point for business, residential and recreational development. A new \$50 million Southeast Texas Entertainment Complex is being built in Beaumont. The multipurpose facility will be home to the South Texas State Fair, a 6,500-seat rodeo arena, a major outdoor concert arena, a regional visitor center, and community parks and recreational facilities.

Big swings in local job creation are still driven by large refining and petrochemical construction projects. The volatile relationship between local construction employment growth and total employment growth is illustrated in Figure 1, which shows percentage change in employment over the previous six months, measured at annual rates of change. On a base of 10,000 to 20,000 construction jobs, several big projects can produce a roller coaster ride in local construction activity. In the spring of 1991, for example, construction grew at an 86 percent annual rate, only to decline at a 46 percent annual rate in 1993.

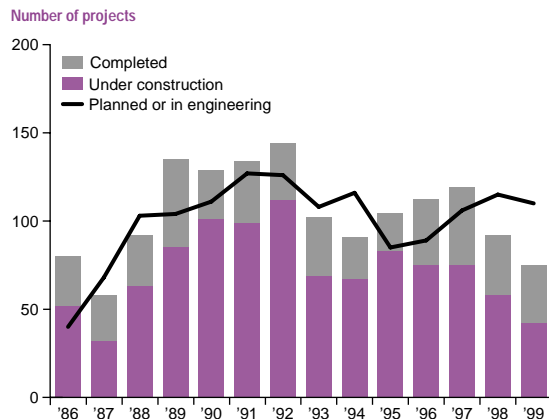
Two local megaprojects peaked last year, after each reached roughly 2,000 workers on site. Clark Refining began to wind down a \$775 million expansion of its Port Arthur refinery, and BASF/Fina is finishing a \$900 million steam cracker in Port Arthur. Motiva, Goodyear, Terra and Chevron also had local projects under way in 1999. The most recent

construction data for BPAO show a buildup in construction work in early 1999 and a likely peak late in the year.

Petrochemical construction on the entire Texas and Louisiana Gulf Coast did peak late last year. *Hydrocarbon Processing* magazine regularly lists all hydrocarbon construction projects in Texas and Louisiana and classifies them as planned, in engineering, under construction or recently completed. Figure 2 shows that the number of projects under construction or recently completed was off sharply last October. The number of projects planned or in engineering remains surprisingly strong, indicating a pipeline of projects ahead if recent high oil prices and weak industry profits do not put these plans back on the shelf. Certainly, BPAO remains a favored location for petrochemical expansion, with recent announcements from DuPont (\$250 million), Goodyear (\$144 million) and Shell (\$200 million). These three projects would provide a combined peak of 1,200 temporary construction jobs.

If there is a lesson for Houston from these data, it is that Houston, as part of the same petrochemical complex, is equally subject to these volatile swings in petrochemical construction. The swings are more easily disguised in Houston by the volume of housing, commercial and highway construction, but this petrochemical cycle is another key element of Houston's highly cyclical economy.

Figure 2
Hydrocarbon Processing Projects Under Construction or Completed in Texas and Louisiana, 1986-99



SOURCE: *Hydrocarbon Processing*, October of each year.

Houston's economy is reported to be quite healthy, despite sluggish activity in all parts of the oil industry. Local purchasing managers report continued improvement in manufacturing.

RETAIL AND AUTO SALES

Retailers suffering from the warm weather and an overstock of winter clothes have turned the corner. Clearing out their winter inventory cost retailers margin because of higher advertising costs and discounts, but excess inventory is now behind them. Sales are running ahead of plan as we move into the spring season.

Auto sales for Harris County were apparently underreported in December because of problems with the state's computerized auto registration system, and the shortage showed up in January totals. January sales were reportedly up an unlikely 66.9 percent. The more meaningful calculation is the change since last January, which is a healthy 4.9 percent increase.

CRUDE PRICES AND DRILLING

Crude prices fell briefly after the New Year, as the Y2K nonevent was absorbed by the market, then rallied based on strong OPEC language indicating a commitment to production cuts and the lowest crude inventories of the last 23 years. A long-awaited cold snap in the Northeast finally pushed crude prices over \$30 per barrel on Valentine's Day.

Despite the push in crude prices, the increase in the U.S. rig count seems to have leveled off, with 750–775 working rigs since late last year. Signs of improved oil-directed drilling evaporated in the United States, and the rig count outside North America continues to decline.

OIL PRODUCT PRICES AND REFINING

Entering the New Year with extremely poor profit margins, refiners cut capacity use to 84 percent by early February. Then cold weather sharply increased demand, and the price of heating oil soared. Upon arrival in

New York Harbor, heating oil briefly sold for more than \$1 per gallon wholesale, setting all-time records. As warm weather returned, traders moved their focus to gasoline out of concern that refiners' low production numbers were leaving them behind the curve in building gasoline inventory for the approaching driving season. Gasoline prices hit post-Gulf War highs in early February. The improvement in heating oil and gasoline prices briefly fattened refiners' margins, although the combination of \$30 crude and warmer weather is once again putting downward pressure on profits.

PETROCHEMICALS

Petrochemical margins also remain under pressure from rising energy prices. Demand has been extremely strong, and inventories of ethylene staged a surprising drop in late 1999, signaling possible price increases ahead. However, increases of 3 or 4 cents per pound would be required simply to restore profit margins to the level enjoyed in early January. Outside of the ethylene chain there has been relatively little opportunity to raise prices at all because of excess capacity, and profits are being hammered.

LOCAL REAL ESTATE

Housing sales of both existing and new homes remain very strong in 2000, although banks and mortgage companies are reporting fewer mortgage applications and perhaps fewer closings ahead. The apartment market has begun to run into serious signs of a glut, with big incentives offered to renters. Projects that stall out at less than 50 percent occupancy are forced to cut rent by \$100–\$150 per month per unit to jump-start sales. Office rents are flat in the central business district and softening in the suburban market in pockets where 3.8 million square feet of space was added last year. More than 40 office projects are being shopped around for tenants and financing, but only four have an announced start date.

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