



Houston Business

A Perspective on the Houston Economy

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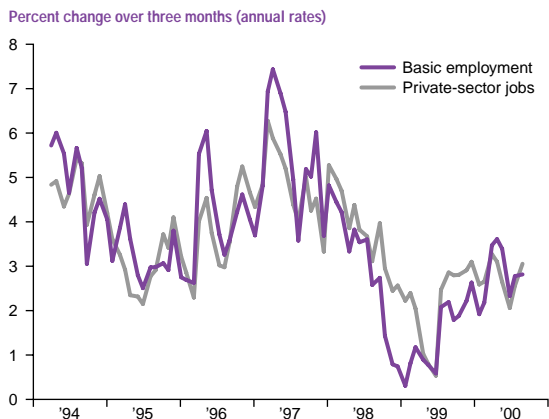
Texas Rides Oil and Technology to New Highs

Head winds have arisen for the U.S. economy in the form of higher interest rates, higher energy prices, a stronger dollar and a lack of headway in the stock market. The technology and productivity boom that has led U.S. economic expansion since 1994 seems to be keeping the U.S. economy firmly on track, however, with only a small moderation in U.S. growth visible in recent statistics. For Texas, this news is mixed, primarily because of the powerful role oil and natural gas still play in the state. Even Texas has winners and losers when oil and natural gas prices rise. But on the whole higher oil and natural gas prices are still good for the state. Combining the rebound in drilling activity with Texas' expanding technology sector sets powerful forces in play to keep the state growing vigorously.

JOB GROWTH

Texas job growth has swung widely in recent months, but over the last year and a half the trend has been toward strengthening. After slowing in the wake of the Asian economic crisis, job growth in the state has hiked back up to a healthy 3 percent annual rate. Figure 1 shows the path of private-sector employment growth since 1994. I use private-sector employment growth rather than total employment growth because of circumstances that affect public-sector job data. For example, the recent return of cafeteria workers and janitors to school payrolls makes it hard to interpret public-sector data at this time of year. The large number of census workers terminated in June and July further complicates interpretation.

Figure 1
Private-Sector and Basic Job Growth in Texas



Also, I supplement the private-sector figure with a measure I call “basic employment,” a measure of export-related employment sometimes termed the economic base. The last issue of *Houston Business* discussed the concept at length and calculated the figures for Houston. The calculations for the state as a whole parallel those for Houston and are weighted toward mining, manufacturing and a select list of services, such as wholesale durable goods and business services.

There were two reasons to look at the basic figures. First, as discussed in the last issue of this newsletter, the basic measure is a crude attempt to isolate the state’s export industries—those that should lead growth and stimulate further expansion in secondary industries such as retailing or auto repair. A recent history of strong growth can sometimes generate robust total employment growth figures for a while, even if the critical base industries are weak, because continued expansion in secondary industries can disguise the fact that primary or basic jobs are no longer growing. That is not the case in Texas, since in the June–August period basic job growth averaged a solid 2.8 percent, only slightly lower than the 3.3 percent for all private employment.

A second reason to look at the basic measure is the return over the summer of 25,000 temporary census workers to the private sector from the public sector. At a time of full employment, many will immediately find private employment; thus, looking only at the private sector (as we have here) might overstate job growth. However, most temporary census workers will probably move to jobs in the sec-

ondary sector, such as relatively low-wage retail or personal service work; few will move quickly to higher paying basic-sector jobs. The fact that basic jobs are growing nearly as strongly as private employment again provides assurance that private-sector employment is not overly biased upward by the arrival of census workers. A conclusion that Texas’ job growth continues at annual rates near 3 percent seems both conservative and safe.

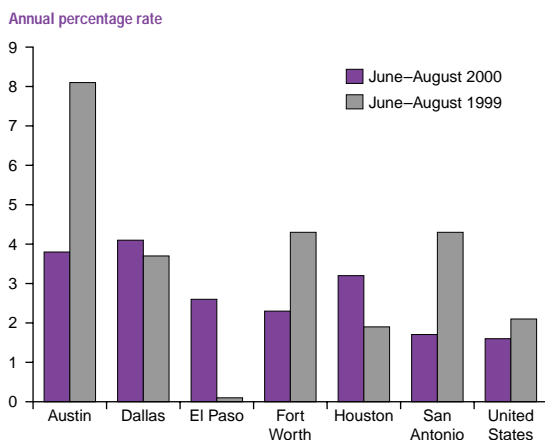
As Figure 2 shows, private job growth is strong among all the state’s major metro areas. Over the June–August time frame, Austin grew at a 3.8 percent annual rate, down from a spectacular 8.1 percent at this time last year. San Antonio had a 1.7 percent annual rate and Fort Worth 2.3 percent, both down from more than 4 percent at this time last year. Dallas (4.1 percent), Houston (3.2 percent) and El Paso (2.6 percent) all accelerated.

The statewide unemployment rate ticked up slightly in August to 4.3 percent from 4.1 percent in July, but it is still well below the year-ago rate of 4.6 percent.

OIL AND HIGH TECH

With the nation importing over half the oil it consumes and domestic oil production declining in recent years, we often think of the United States as a has-been in the oil business. But it remains a very important industry, both in the nation and in Texas. The United States is still the largest oil producer in the Western Hemisphere, ranking only behind Saudi Arabia and the former Soviet Union in global oil pro-

Figure 2
Private-Sector Job Growth Remains Strong in Major Metro Areas



duction. It ranks second to the former Soviet Union in natural gas production. Among the individual states, Texas is No. 1 in both oil and natural gas production. The Texas economy continues, on net, to benefit from higher oil prices and more oil field activity.

With West Texas Intermediate over \$30 per barrel for most of this year, natural gas prices setting a chain of record-high prices and the domestic rig count over 1,000, the U.S. oil industry has made a dramatic comeback from its struggles of 18 months ago. Texas' drilling activity bottomed out, along with the nation's, in April 1999 at 180 working rigs. The Texas rig count has since zoomed back to 381 working rigs. However, data from the Texas Workforce Commission continue to show virtually no increase in oil extraction employment since May 1999.

Even if jobs in the oil industry are not adding to current employment estimates, increased drilling activity has had a positive impact on durable manufacturing in the state. Durable manufacturing in Texas grew at a 16.8 percent annual rate in August and at a 7.8 percent annual rate over the June–August period.

High tech also drives durable goods manufacturing in Texas, and the ongoing rebound in Asia and the global economy has benefited both high tech and oil. One way to see the separate influence of the two factors on the state economy is to assume that in recent years durable manufacturing sectors have been primarily driven by high tech in Dallas and Austin

Table 1
High Tech and Energy Drive Machinery Employment
(Percent growth, year over year)

	June–August	
	2000	1999
Industrial machinery		
Austin	22.2	18.4
Dallas	3.6	-1.5
Houston	2.9	-18.7
Electrical machinery		
Austin	12.0	4.4
Dallas	7.7	.7
Houston	7.9	-6.5
Instruments		
Austin	NR	NR
Dallas	-9	-3.5
Houston	2.2	-12.1
All durables		
Midland–Odessa	17.5	-3.0

NR = Not reported by Texas Workforce Commission.

Table 2
Border Retail Job Growth by Metro Area
(Percent growth, year over year)

	June–August	
	2000	1999
Statewide	3.5	3.8
Brownsville	6.0	7.6
El Paso	6.8	5.8
Laredo	6.6	5.7

and by oil in Houston and Midland. Table 1 shows a rebound in all these cities in key durable goods industries.

High tech in Texas primarily means wireless communications, computers and semiconductors. Contacts in the state's high-tech sector point to very strong demand for all the state's high-tech products. The only weakness, or potential weakness, is concern about semiconductor pricing for the next 12 months. The semiconductor industry is highly capital-intensive and adds capacity in large blocks; it could be susceptible to excess capacity later this year or next if demand were to slow. Emerging signs of weakness in computer-related demand for chips and a potential slowdown in the national economy raise some cautionary notes about where the industry is headed.

MEXICO HELPS OUT

The Mexican economy continues to advance at a torrid pace, with GDP growing at an 8.1 percent annual rate in the first quarter and a 7.5 percent annual rate in the second. The Mexican economy's strength is important to Texas because 45 percent of the state's exports go to Mexico. Since last September, Texas exports have continued to grow at a solid 16.4 percent annual rate. This is in spite of a trade-weighted dollar that has risen 3.5 percent since January. Asia and Mexico have been the most important foreign customers for Texas goods in 2000.

Mexico's other contribution is more direct: retailers in Texas border cities benefit from Mexican shoppers. As Table 2 shows, the strong peso and rising Mexican incomes have put Brownsville, Laredo and El Paso retailing on an accelerated growth path. Statewide retail job growth over the June–August period averaged a healthy 3.5 percent annual rate. Since last year these three border cities have created retail jobs at a pace that exceeds 6 percent.

Houston's economy continues to gain speed, with job growth over the past four months moving above a 4 percent annual rate. Houston's durable goods manufacturing continues to lead job growth, spurred by the powerful recovery in oil- and gas-related products. The Houston survey of purchasing managers also continues to point to substantial strength in the industrial sector, while its national counterpart now indicates no growth.

RETAIL AND AUTOS

A marked contrast continues between a weak general retail picture and strong auto sales. Retailers fell behind when the state tax holiday in August was less successful than expected, and since then they have been unable to meet plan or clear inventories. Sales and promotions are under way, and more are expected.

September auto and truck sales, however, increased 16 percent over the same month last year. For the year, auto sales are up 15 percent, and Houston seems to be headed for a third consecutive record year.

OIL AND NATURAL GAS

The market for crude oil over the past six weeks has generally reflected a system stretched to its limit, lacking flexibility and tested by unseasonably cold weather, tropical storms and violence in the Middle East. The result was substantial volatility. The price of crude has remained in the \$32-\$37 per barrel range for most of this period.

Natural gas prices surpassed \$5 per thousand cubic feet. Their volatility reflected many of the same factors that moved oil prices. Storage levels are more than 10 percent below last year's levels, and the heating season has arrived. Winter weather has been warmer than normal for several years, and a normal winter this year would cause price spikes and curtailments for industrial customers.

Heating oil inventories have consistently

run 30 percent to 35 percent below year-ago levels, and cold weather in the Northeast in October further delayed the buildup of stocks. Refiners continue to enjoy good margins, and Gulf Coast refineries have consistently operated at very high levels. A number of companies have announced plans to continue operations through the usual October maintenance season in an effort to build heating oil inventories.

OIL AND GAS DRILLING

Drilling activity continues to improve, with 1,054 U.S. rigs at work at the latest reading. Tropical storms briefly took out a number of rigs in the gulf. Business is very good, although still not stretched to the limit. International activity is now rising rapidly but remains 100 rigs or so below the prior peak. A slow international market and reluctance by major companies to undertake megaprojects explain the slack still left in the market.

PETROCHEMICALS

Despite huge increases in production costs due to higher natural gas and liquids prices, producers are unable to pass through price increases. In fact, excess capacity and slack demand have forced down the price of key products such as ethylene, polyethylene and polyvinyl chloride by several cents per pound. Margins are poor and not expected to improve soon.

FINANCIAL INSTITUTIONS

Loan demand is stable, with smaller banks and credit unions most positive about the current interest rate environment. Stable rates have boosted auto and commercial lending activity. Some larger banks that rely more heavily on fees from advisory services and other off-balance-sheet activity report a cooling of this type of income along with the national economy. Credit quality has deteriorated slightly.

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