

AFTER THE BOOM

Texas Economy Downshifts in Energy Bust | Annual Report 2015

Slow Growth in Texas After Energy and Trade Ebb

Pia M. Orrenius and Keith R. Phillips | Annual Report 2015

The sudden reversal in Texas' economic outlook in 2015 is the focus of five essays in this annual report.

State job growth downshifted from 3.7 percent in 2014 to 1.3 percent in 2015. Declining oil prices were the main culprit, but a stronger dollar also played a role, helping reduce state exports. The end result has been a recession in the goods-producing sectors of energy extraction and manufacturing, which together lost 113,000 jobs last year. The service-providing and construction sectors, meanwhile, continued to expand, gaining 271,000 jobs in 2015.

In the wake of this shift, Federal Reserve Bank of Dallas economists assess what's next as Texas' economy moves forward.

In their essay, Michael Plante and Mine Yücel lay blame for the oil price downturn on an excess supply of crude oil. Texas rode the shale oil boom for several years until a global bust made the domestic oil industry a victim of its own success. U.S. crude production had soared with the adoption of hydraulic fracturing, or fracking, of shale formations, from 5.5 million barrels per day in 2010 to 9.4 million barrels per day in 2015. The U.S. became the world's third-largest producer of crude. Once oil prices began sinking, the Organization of the

Petroleum Exporting Countries didn't act to restrict supply, and prices dropped further. Balance in the market—defined as the point at which inventories stabilize—is at best two years away, Plante and Yücel suggest.

For many Texans, the collapse in oil prices brings back haunting memories from the 1980s recession and banking crisis. Oil prices fell 70 percent between 1982 and 1986, and one-third of Texas banks failed or needed Federal Deposit Insurance Corp. assistance, as Kory Killgo and Robert Moore remind us in their essay on the state's banking sector. While they caution that the current oil bust will be no repeat of the 1980s, early warning signs confront area banks.

Commercial and industrial loan performance deteriorated sharply in the second half of 2015, and new lending slowed. Texas banks are also heavily exposed to commercial real estate, which has continued to do well even while remaining vulnerable to flagging demand from energy and related firms. While loan demand has receded from its lofty highs—with additional slowing likely in the near term—institutional buffers installed since the 1980s, such as the introduction of interstate banking, make a repeat of the past state banking crisis highly unlikely, Killgo and Moore conclude.

John Duca's essay focuses on Texas housing markets and the failure of the supply of new housing to keep up with soaring demand during the shale oil boom. In a state with a historically responsive housing supply, this unusual scenario led to a record run-up in Texas house prices. By comparing prices with rents and incomes, Duca concludes areas vulnerable to the energy downturn, such as Houston, may experience mild declines in house prices while other large Texas metros may simply experience slower price appreciation. The decline in affordability, meanwhile, is unlikely to completely recede; the state may have permanently lost some of its cost-of-living edge relative to the rest of the nation.

Pia Orrenius surveys state labor markets in the wake of the shale oil boom, pointing out that the boom's end may exacerbate widening wage inequality in coming years. Commodity run-ups tend to create relatively high-paying jobs without raising the skill premium, funneling good jobs to blue collar workers. Without the countervailing force that an energy boom brings, Texas is exposed to

the long-run national trend of labor market polarization, which disproportionately creates jobs at the bottom and top of the wage distribution while the middle stagnates.

Mark Wynne's essay discusses the large and growing volume of Texas exports and addresses the impact of China's economic slowdown. By some measures, up to one-third of global economic growth in recent years can be attributed to China—a worrisome statistic given that Chinese authorities expect much weaker growth in the next several years. While Texas exports to China have grown at an annual rate of more than 15 percent over the past two decades, China only comprises 5 percent of state exports. Wynne concludes that this small share will limit the impact of China's economic slowing and the depreciation of its currency.

From 2010 to 2014, the Texas economy grew strongly, fueled in part by the booming energy sector and increased exports. This expansion occurred across the entire wage distribution, with much stronger job growth than the nation in middle- and high-wage jobs. The oil price collapse and strengthening dollar in 2015 sharply slowed economic growth. Still, relative to the 1980s and other energy-producing states, Texas performed remarkably well.

Heading into 2016, weak oil and natural gas prices and a still-strong dollar suggest challenges remain. Growing numbers of bankruptcies in the oil and gas sector and softening trade with China will likely provide a backdrop that will remind some of the state's bust three decades ago.

Dallas Fed economists who have analyzed the state's economy over the past several decades conclude that, despite the significant challenges, Texas will continue adding jobs and probably avoid sharp declines in nonenergy sectors such as banking and residential real estate. While job growth will likely be weak—with activity concentrated at the low and high end of the pay distribution—a more diversified Texas economy will help the state avoid a repeat of the 1980s.