An Inauspicious Start to the New Year

2015 proved to be difficult for the oil and gas industry. Over the course of the year, drilling permits fell 41.6 percent, the North American rig count fell 61.4 percent, and the price of crude fell 29.6 percent. That's on top of the declines the industry already suffered in 2014.

The new year hasn't started any better. West Texas Intermediate lost $4.93/bbl the first week of trading, a drop of 13.0 percent. Crude prices will likely fall further before hitting bottom. And the North American fleet lost 34 drilling rigs the first week of January. At 664, the rig count stands at a level not seen since August of 1999.

The causes of the downturn have been widely reported—concerns over slower growth in China, all-out production by OPEC, stubbornly resilient U.S. production, and record high crude inventories, both in the U.S. and abroad. Even the ongoing unrest in Libya, Yemen, Iraq and Syria hasn't impacted the market. Perhaps the greatest indicator of how abnormal the current situation is—in early January, Saudi Arabia broke diplomatic ties with Iran and crude prices fell. Adjusted for inflation, crude is trading at the same level it traded in late 2002.

2016 will be even tougher for the industry. The Texas Railroad Commission issued only 727 drilling permits in December, the fewest for the month in records dating back to 2003. The commission typically issues 1,400 or more in the month. Iranian crude will likely hit the global market this spring, adding to an already glutted market. And the recent drop in prices has further eroded cash flow, impacting the industry's ability to drill wells, service debt and meet payroll. The long-expected shakeout in the energy industry may finally happen this year.

The impact outside energy has been uneven so far. Office leasing is down, but retail construction is up. City of Houston sales tax collections have slipped, but vehicle sales set a new record. Home closings have fallen. Airport and port traffic continues to grow. And employers continue to add jobs, just enough to offset losses in energy.

Houston's Job Growth

The Texas Workforce Commission reports that the Houston metro area added 4,800 jobs in November, which was the third weakest November in the past 25 years. The region typically adds 10,000 to 12,000 jobs in the month.

Since December 2014, the goods producing sectors have lost 20,000 jobs while the service providing sectors added 33,800 jobs. Employment in mining and logging (i.e., energy) declined by 7,600 and manufacturing by 16,700. Construction is the only goods producing sector to have added jobs during this period, with a gain of 4,300 workers. The strongest job gains in the service providing sectors occurred in accommodation and food services (+17,200), health care and social assistance (+13,100), and government (+10,400).

Houston Economy: It's Bad, But It's Not Awful

The four-star business lunches are disappearing. Upscale apartments that once were filling fast now are offering free rent specials. Factories that ran around-the-clock to produce oil hardware are slashing shifts or shutting down entirely. The hard-luck jobless lining up for career counseling include the suit-and-tie engineers, geologists and energy executives who once earned six-figure (or higher) salaries.

As Houston enters the second year of the worst oil downturn in decades, its once-booming economy has sputtered, and the strain finally is starting to show. Houston could flirt with recession in 2016 as the oil and gas industry cuts jobs and spending, but the local economy isn't collapsing the same way it has during prior oil busts, and most economists don't think it will happen.

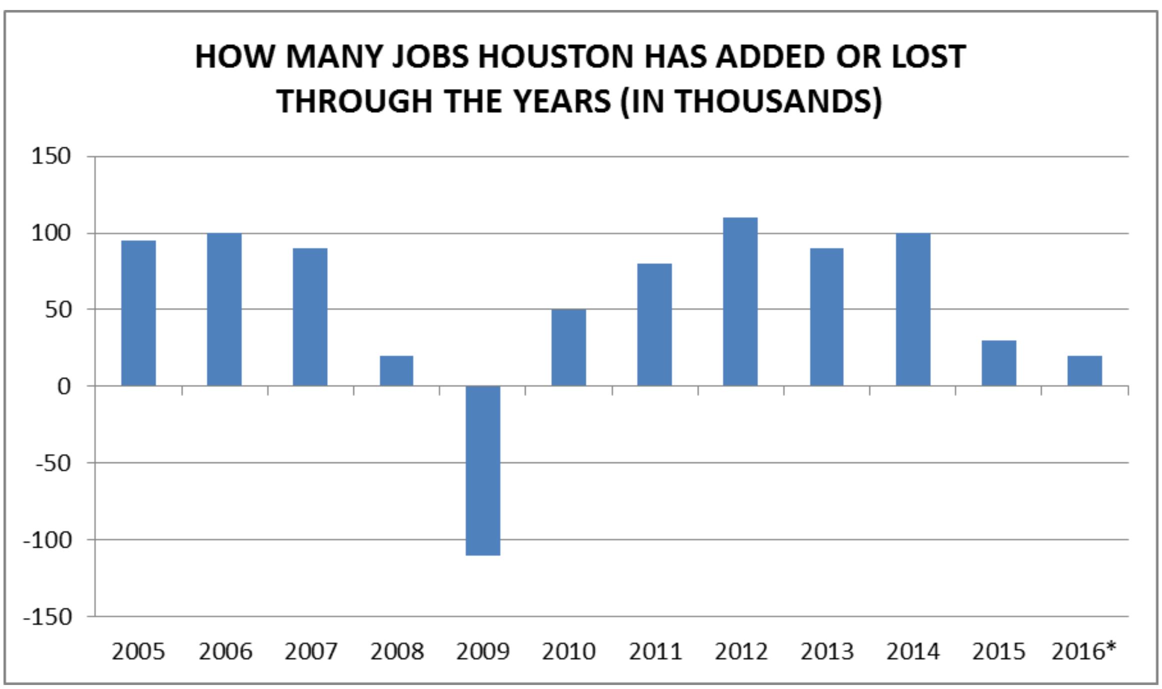
"It's bad, but it's not awful," said Ed Friedman, Director at Moody's Analytics. The infamous 1980s oil slump reverberated across Houston, causing 1 in every 7 local workers to lose their jobs before the market eventually recovered. This time around, a healthy national economy coupled with continued population growth and a surge of construction is buffering the metro area from deeper trouble. The city is harnessing momentum from other booming sectors – petrochemical, refineries, healthcare, construction – to offset the losses in energy and energy-related manufacturing. "Houston is not the same Houston it was 30 years ago," Friedman said. Hospitals, clinics and medical offices are expanding as they try to keep up with a population boom of nearly 10 percent since 2010.

Downtown Houston has been revitalized with new office towers and residential construction that sprang up when oil was hovering around $100 a barrel the previous two years. And an estimated $50 billion in investment along the city's petrochemical corridor is in the works, enough to build downtown Houston two times over. That industrial renaissance is bringing thousands of new construction jobs to the area that is helping compensate for the losses in energy. Nevertheless, economists predict that 2016 likely will be an austere year for Houston. The oil and gas industry is bracing for anemic crude prices over the next 12 months, and most analysts don't expect meaningful improvement until 2017. As a result, Houston could lose as many as 50,000 jobs in manufacturing and oil & gas before the industry recovers. How much those cuts drag down the local economy is an open question. The city still is expected to see a net gain in jobs this year that could reach nearly 25,000. While not the 104,700 jobs created during the oil boom's heyday in 2014, any sort of gain when crude is trading below $40 a barrel is widely considered a positive outcome.

The effects of deepening spending cuts at energy companies and the barrage of layoffs have started to creep into various parts of the local economy. The metro area's unemployment rate has climbed to 4.9 percent from 4 percent last December, amid a flurry of oil-related job cuts and factory closures that started about a year ago. Sales and use tax revenue, as reported in December, slipped nearly 7 percent from the same time last year, signaling a broader fallout from the global oil slump that has led to bankruptcies and layoffs in Houston and beyond. Sales of vehicles starting at $100,000 lost 20 percent of its market share between September and October. Across the Houston area, real estate has softened after four years of booming growth. And the effects are playing out in what has been a red hot rental market. Layoffs within the oil and gas industry were swift and deep for most of 2015, starting with the factories that churn out rigs, drill bits and steel pipe, then extending into corner offices as crude prices remain well below levels to justify additional drilling and exploration. And the longer the slump lingers, the harder it becomes for Houston's energy workers to find new jobs in an industry that has produced as much as 40 percent of the city's job growth over the past 25 years.

More layoffs are expected in the coming months. Those losses will continue to create an undertow that will pinch local spending, home prices and tax revenue, BBVA Chief Economist Nathaniel Karp said. "We're going to lose some of the high-paying jobs that have been driving up the economy over the last few years and we're going to gain some of the lower paying Jobs," he said. If Houston slips into a mild recession, the city may already be out of it by the time economists can measure it, as government data often lags by several months. "We've got a pretty good chance of moving into recession in the first quarter, if we're not already in one," said Harvison of the ISM. Still, any contraction in economic activity will likely be short-lived as the pace of energy layoffs slows and Houston's population continues to grow.

In addition, the flurry of construction activity in the region's petrochemical corridor isn't slated to peak until late 2016 or early 2017, with Houston expected to add up to 10,000 more construction jobs next year, according to the Greater Houston Partnership. While those jobs are temporary and transient, they might provide the metro area with enough lifelines to gird against the steep financial turmoil of prior oil busts.



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U.S. Job Creation Finished Year with a Strong Sprint

The last time the U.S. economy registered such a prolonged stretch of impressive job creation, Facebook didn't exist and Beyoncé was still a member of Destiny's Child. For all of 2015, the nation added 2.65 million jobs, capping a two-year, back-to-back gain that was the best since the late 1990s, the government reported Friday. "I think this really is illustrative of the fact that economic momentum in the United States is still awfully strong," said Carl Tannenbaum, Chief Economist at Northern Trust. The year ended with a particularly strong sprint. In December, employers hired an additional 295,000 people, the Labor Department said, and October and November were revised up by a total of 50,000, pushing the average for the last three months to 284,000. Meanwhile, at 5 percent, the jobless rate, which was unchanged from the previous month, has fallen by more than half since exceeding the 10 percent mark in October 2009. Looking ahead, the biggest question is whether growth will remain strong enough to keep hiring advancing, or whether turmoil in China and elsewhere will weigh down the U.S. economy.

The main shadow darkening the last monthly jobs report was further evidence that wage growth for the typical worker remains sluggish. Average hourly earnings fell slightly in December, leaving the overall yearly gain at a meager 2.5 percent. Based on the latest figures, the average monthly gain in jobs last year of 221,000 was up from the 2013 average of 199,000 though short of the 260,000 reached in 2014. The remarkable thing is how consistent employment growth has been over the past three or four years," said Mark Zandi, Chief Economist at Moody's Analytics. "That's quite an achievement." Pressure to raise pay at a faster pace will eventually mount, he said. Analysts noted that wages, which are measured in nominal terms, are better than they might seem at first glance, because inflation fell to such low levels last year. Adjusted for changes in prices, the real gain was roughly 2.1 percent, the highest since the recovery began more than six years ago. While that is not a bad showing, said Betsey Stevenson, an Economist at the University of Michigan and a former member of Obama's Council of Economic Advisors, most of those gains have occurred at the top end of the wage distribution. "The middle class has continued to get hammered, and what we've seen is increasing inequality," she said. "That was true in the recovery and also true prior to the recovery." Douglas Holtz-Eakin, a former advisor to President George W. Bush, who blamed the anemic growth in productivity, which he said helps depress wages. The labor participation rate barely ticked up to 62.6 percent last month from 62.5 percent.

Oil Companies Scrap Projects

Oil companies have scrapped $380 billion in new projects since the oil market downturn began a year and a half ago, Wood Mackenzie said. The energy research firm's dollar-figure estimate has nearly doubled since its first report on the matter last July, as oil prices crashed from around $60 a barrel in the summer to about $30 a barrel last week. About $170 billion of the scrubbed projects Wood Mackenzie identified had been scheduled to begin production from 2016 to 2020. That means 2.9 million barrels a day that the industry had planned to bring up won't hit the market until the 2020s. The industry since last summer has cancelled 22 major projects tied to 7 billion barrels of oil equivalent in reserves, bringing the number of scrapped projects since the start of the downturn to 68. All told, that's 27 billion barrels of oil equivalent that will have to wait for production until prices recover. On average, the projects would lose money unless crude prices were $62 a barrel, Wood Mackenzie said.

Oil May Sap Texas Job Growth

Texas could lose jobs for the first time in seven years unless crude prices in 2016 stage a major recovery, the Federal Reserve warned on January 12th, as U.S. oil briefly tumbled below $30 a barrel. A top economist for the Federal Reserve Bank of Dallas forecast 1.4 percent job growth in Texas this year, a third of what it was in 2014, but said that such a bump in non-farm payrolls will materialize only if oil prices rise and spend a big portion of the year in the $40 to $50 a barrel range. If crude prices don't climb back up, Fed Sr. Economist Keith Phillips said, "then I expect job growth to slip into negative territory as Houston gets hit much harder and greater problems merge in the financial sector". "But we are constantly surprised by oil prices," he added. "If they jump up past $60 and hold, Texas will likely return to growth above the national average." U.S. oil hasn't topped $60 since June. Phillips said Texas' jobless rate could rise to 4.9 percent, up from 4.6 percent, by the end of the year if oil is in a $40 to $50 range. Last year, he added, Texas lost about 50,000 energy jobs, accounting for about a third of the state's job losses.

Texas hasn't had a full year of negative job growth since 2009 during a national recession, when jobs declined 2.8 percent year over year, according to Texas Workforce Commission data. The agency reported positive growth for the first 11 months of 2015. It hasn't yet posted December jobs numbers. The Houston-area economy, which has a closer link to the oil industry than the broader state, kept adding jobs each month as well, but always at a slower pace. Local employers added 23,700 jobs in November, a fraction of the 103,400 new jobs in November 2014, when crude traded above $70 a barrel. In Tuesday, January 12th trading, the New York Mercantile Exchange, U.S. benchmark West Texas Intermediate crude fell 97 cents to $30.44 a barrel, its lowest close since December 1, 2003. It has fallen 18 percent this year and briefly dipped as low as $29.93 a barrel Tuesday before rising at midday. The U.S. Energy Department estimates domestic crude will average $38.54 a barrel in 2016. If crude prices recover by a third to two thirds this year, Texas payrolls could add about 161,000 jobs – slightly more than last year. But even then, the Dallas Fed said, Texas job growth would come in well below the 410,900 jobs the state added in 2014.

Job cuts announced in the energy market:

- BP plans to shed 4,000 oil production jobs this year, about a fifth of its exploration and production business. The cuts would double the number of jobs BP has axed so far.
- Dresser Rand is shutting down a local support facility and cutting 72 jobs.
- Cameron International will cut 55 jobs in conjunction with the closing of the Drilling Systems – Topsides Control Group facility.
- Shell will cut 2,800 additional jobs if its merger with BG Group is successful, constituting 3 percent of the combined company's workforce.

- Schlumberger revealed plans to cut thousands of more jobs.
- National Oilwell Varco announced more job cuts – they will cut 900 more jobs in Norway due to fewer orders amid low oil prices.

Energy Bankruptcies Expected to Continue

Houston-based Vantage Drilling Co. became the latest energy company to file for bankruptcy protection under Chapter 11 of the Bankruptcy Code on December 3, 2015. The reality of the year's tumultuous oil price market has marred Texas-based exploration and production companies – and the companies that service them such as Vantage – with insurmountable debt. The result: a year of many more bankruptcies. North American exploration and production companies account for 37 bankruptcies filed in 2015, 17 of which were filed in Texas. Houston-based companies accounted for 9 of the 2015 North American E & P bankruptcies, according to a report from Haynes and Boone LLP. Total cumulative secured and unsecured debt stemming from the bankrupt companies so far in 2015 is $13 billion. The rise in bankruptcies was predicted. August boasted the most bankruptcies by far, with 10 of the 37 taking place that month. The first half of 2016 shows no sign of deviating from current bankruptcy trends, said Buddy Clark, a Houston-based partner at Haynes and Boone. "Based on current work for our clients that include producers, oil field service companies and capital providers, there will likely be as many E & P companies filing for bankruptcy in the first half of 2016 as we saw in 2015," said Clark. "If prices don't recover by next summer, there will be even further fallout over the remainder of the year."

Sources: Greater Houston Partnership; Houston Chronicle, Houston Business Journal