Three Growth Engines in Houston

Three engines drive Houston's growth: oil exploration, foreign trade and the U.S. economy. The region receives help from population gains, but that's tied to job growth. Large construction projects, like the recent petrochemical boom, assist as well. But for the most part, Houston relies on the big three—energy, trade and the U.S. economy. Lately, energy hasn't contributed much to Houston's growth.

- The industry lost 93,000 jobs during the fracking bust. So far, less than half of the jobs have been recovered.
- The U.S. rig count topped 1,083 in December '18 but slipped to 898 as of early September.
- Crude rose to $75 per barrel in October '18, prodded by U.S. sanctions on Iran. Surging U.S. production, waivers for countries buying Iranian crude, and fears of a global slowdown have sent prices to the mid-$50s.
- The U.S. oil field service sector has laid off 8,900 workers so far this year. Locally, the sector peaked in May and has cut 1,200 jobs since.
- The law firm Haynes and Boone reports that 36 North American exploration and service firms filed for bankruptcy within the first eight months of this year. That figure compares to 40 in all last year.

The U.S. and global economies must remain healthy for Houston to continue growing. But those engines are sputtering as well. The World Bank, the International Monetary Fund (IMF), and the Organization for Economic Co-operation and Development (OECD) all forecast slower growth this year.

Unemployment Rate

Houston's unemployment rate was 4.0 percent in July, up from 3.8 percent in June but down from 4.5 percent in July '18. Houston's unemployment rate matches that of the nation (4.0 percent) but is above that of Texas (3.7 percent). The rates are not seasonally adjusted.

U.S. Outlook

The National Association for Business Economics (NABE) recently asked its members about the timing of the next recession. The majority of respondents expect a U.S. recession within the next two years. The latest data seem to support their pessimism. The U.S. created only 130,000 jobs in August. Job growth has averaged 158,000 per month thus far this year, below the average monthly gain of 223,000 in '18. Industrial production, which includes the output of all U.S. mines, factories and utilities, has fallen 1.4 percent since December. Business investment appears to have peaked in Q1/19, slipping 1.6 percent in Q2/19.

The consensus among the 75 economists surveyed by the Wall Street Journal in August is that U.S. growth will slow from 2.0 percent in Q2/19 to 1.6 percent by Q4/20. The danger is that when growth falls below 2 percent, the U.S. economy is vulnerable to external shocks like an oil price spike or an interest rate hike. Those two factors contributed to four of the last six U.S. recessions. Given the state of oil markets and current level of interest rates, both are unlikely now. This time the external shock may be the trade war.

Recent US Recessions	
Date	**Cause**
'69 – '70	Interest rate hikes, fiscal austerity
'73 – '75	Stock market crash, oil price spike
'80 – '82	Interest rate hikes, oil price spike
'90 – '91	High debt, consumer pessimism, oil price spike
'01 – '02	Dot-com bust, weak business investment 9/11
'08 – '09	Subprime mortgage crisis

Houston tends to lag the U.S. going into a recession. Contrary to popular belief, Houston doesn't lead the U.S. out. The region often lags the U.S. coming out as well.

The early 1990s recession began nationally in July 1990 but Houston didn't see job losses until July 1991. By August, however, U.S. employment began to grow again. Houston wouldn't begin to recoup its losses until early 1992. Job growth remained weak until early 1994, when Houston started to benefit from strong U.S. growth and the dot-com boom.

The '01 recession started in March of that year. Houston didn't suffer job losses until December. The U.S. economy began to grow again that month, but the nation didn't see consistent job gains until October '03. Houston waited until March '04. The recovery finally received a boost from a surge in oil demand driven by growth in China. Houston also benefited from a housing boom—the region built more than 175,000 single-family houses over the next five years. This was the precursor to the subprime mortgage crisis when lenders extended credit to homebuyers who shouldn't have qualified for loans.

The Great Recession began in December '07 but Houston didn't experience sustained job losses until December '08. Houston recovered quickly from the Great Recession, but only because a fracking boom was underway in the Eagle Ford shale and energy-related employment grew at double-digit rates.

The most recent recession, which started in late '14 and lasted until early '17, was a local event brought on by the collapse in oil prices. Houston lost nearly 5,000 jobs over two years while the nation added 6.4 million. Momentum from the '10-'14 boom, the surge in chemical plant construction, and population growth, albeit below historic trend—helped mitigate Houston's job losses.

Local Job Growth Likely Overstated

Metro Houston created 93,600 jobs, a 3.0 percent increase, in the 12 months ending July '19, according to the Texas Workforce Commission (TWC). Job growth is likely overstated, however. The Houston Purchasing Manager's Index, a leading barometer of the region's health, is barely positive. Export growth has slowed to single digits. And metro-area construction is well below last year's pace. TWC often struggles to accurately estimate job growth. Last year, the agency reported the nine-county region created 101,800 jobs in the 12 months ending July '18. TWC revised that to 68,400 jobs when it issued its benchmark revisions in March this year.

Houston Manufacturing Expands but Outlook Darkens

Manufacturing activity in Houston expanded in July but the forecast for the near future is not so bright, according to a survey of supply chain executives. The Houston Purchasing Managers Index found that manufacturing activity ticked up last month to 51.4 from 51.2. Index readings over 50 generally indicate manufacturing expansion, and below 50 indicates contraction. But the index that measures executives' expectations for the next three months sank further as they see the sector contracting. The index fell to 48.7 from 49.4 in June. Manufacturing is slowing in the U.S., Europe and Asia. In Texas, manufacturing executives have reported in surveys that business is softening and tariffs are cutting into their profits as duties raise costs on imports and make U.S. exports less competitive in China, according to the Federal Reserve Bank of Dallas. As slowdown in the energy industry weights on manufacturing, lower crude prices and tighter financial conditions lead oil and gas companies to restrain or cut spending. Manufacturing is viewed as a leading indicator, meaning its fortunes, can presage the direction of economic growth in Houston.

Texas Oil Industry Sees Growth

The Texas energy sector has managed to add jobs and increase oil and gas production over the past 12 months despite lower oil prices, but fears of a slowdown loom for the rest of this year and into 2020. The report from the Texas Independent Producers & Royalty Owners Association highlights the industry's ability to advance technologically and gain efficiencies, but it also warns that slowing drilling and a weakening global economy could make for a challenging future – at least in the near term. Global oil demand growth is slowing, crude prices are muted and a driving force behind all this, the U.S./China trade war, has shown more recent signs of escalating rather than settling. "Unless these issues can be resolved, the United States could experience a slowdown in domestic production growth and an insufficient number of wells to offset the decline rate in the short term," said Ed Longanecker, President of TIPRO. Production volumes from onshore shale wells can decline rapidly after the first couple of years, so new drilling is required to keep pace and prevent overall production from falling. Still, the report mostly focused on the positives for the industry. Despite a partial industry slowdown in 2019, the Texas energy sector has gained nearly 10,000 jobs in the past 12 months. The sector employs about 365,500 direct jobs for the state, the report said. Texas is producing a record 5 million barrels of oil per day, about 40 percent of total U.S. production, estimated at 12.5 million barrels. The Permian Basin, which stretches across West Texas into southeastern New Mexico, is churning out about 4.4 million barrels daily. The Permian now accounts for nearly two-thirds of Texas oil production, TIPRO said. The industry has learned to do more with less. Rigs can drill more wells from single locations more quickly, while also drilling increasingly longer and deeper horizontal wells. But fewer rigs also mean fewer workers over time. "Technological advancements continue to make oil and gas operations more efficient, allowing Texas to achieve record-setting production of oil and natural gas despite a dip in drilling activity," Longanecker said. The numbers of rigs drilling in Texas dipped below 450 in August, down from about 525 a year ago. Texas still accounts for nearly half of all operating rigs in the U.S. Drilling permits also have slipped. In July, the state issued 912 new well permits, down from 1,001 in June and 1,153 in July 2018. The number of wells brought into production also fell in July to 699, compared with 940 a year earlier, TIPRO said. Well completions are down 12 percent in 2019, compared with this point a year ago, the report said.

Sources: Littler Mendelson P.C.; Houston Chronicle; Houston Business Journal; Wall Street Journal; Greater Houston Partnership