Outlook for the Houston Economy

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AAREA Houston
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In 2014, the U.S. economy gained momentum as the Texas economy outperformed the nation.

**Real GDP Growth**  
*(Quarterly % Change)*

- Average Growth(%) 2009Q3-2014Q2
  - United States 1.0%
  - Texas 1.1%

Note: Seasonally Adjusted  
Source: Bureau of Economic Analysis and Dallas Federal Reserve
Economic indicators for the United States present a picture of higher growth at the end of 2014.

**United States Business Cycle Index and Leading Index**

(m-o-m % Change, Index Jan2007 = 100)


Source: Conference Board
Texas economy continued to expand at greater rate than historical trend

Texas Business Cycle Index and Leading Index
(m-o-m % Change, Index Jan2007 = 100)

Peak Date: June 2008
Trough Date: November 2009
Contraction peak to trough 18 months

Note: Seasonally adjusted. Composite Index of 3 Coincident Indicators (1987=100). Composite Index of 8 Leading Indicators (1987=100). Shaded area refers to recession
Source: Dallas Federal Reserve
U.S. job growth continues to strengthen as Texas outpaces the nation

Employment Growth Rate
(m-o-m % Change)

January to November 2014
US monthly average 246,554
Texas monthly average 39,963

Notes: Seasonally adjusted
Source: Bureau of Labor Statistics
Unemployment rate has declined sharply, reaching six-year low

Unemployment Rate

(%)
U.S. inflation has remained low while Texas inflation is higher as the regional economy heats up ...

**Inflation**
(y-o-y % change;)

Note: Seasonally adjusted
Source: Bureau of Labor Statistics and Dallas Federal Reserve
... accompanied by sluggish wage growth at the national level, while Texas economy upward expansion started to put upward pressure on wages.

**Average Hourly Earnings All Employees: Total Private**

(y-o-y % change)

Note: Seasonally adjusted.
Source: Bureau of Economic Analysis.
Houston faced similar headwinds but has grown faster than the country and the state...

**Business Cycle**  
(Index Jan2007=100, m-o-m % change)

Note: Seasonally adjusted  
Source: Dallas Federal Reserve
... boosted by the states energy boom

Texas Production of Crude Oil and Rig Count
(\#, millions of barrels)

Source: Baker Hughes and U.S. Energy Information Administration
... leading to very strong growth and tightness in the Houston labor market

**Houston Nonfarm Employment and Unemployment Rate**
(\textit{thousand, \%})

Note: Seasonally adjusted. Estimates for Texas use and early benchmarking and two-step seasonal adjustment.

2014 Houston employment growth was broad based across sectors ...

Employment by Sector
(y-o-y % change November 2014)

- Mining and logging: 9.5%
- Construction: 8.6%
- Educational & Health Services: 7.7%
- Transport, Warehousing & Utilities: 7.3%
- Leisure & Hospitality: 4.8%
- Professional & Business Services: 4.0%
- Information: 3.7%
- Manufacturing: 3.0%
- Financial Activities: 2.7%
- Government: 2.4%
- Retail Trade: 2.2%
- Wholesale Trade: 0.8%

Employment by Energy Sector
(y-o-y % change November 2014)

- Support Activity for Mining: 13.8%
- Oil & Gas Extraction: 7.1%
- Chemicals: 5.3%
- Petroleum and Coal Products: 4.9%
- Pipeline Transportation: 4.2%

Source: Bureau of Labor Statistics
... causing wages to increase in Houston

Average Hourly Earnings All Employees: Total Private and Total Wages
(y-o-y % change)

Note: Seasonally adjusted. Deflated with Consumer Price Index for All Urban Consumers: All items in Houston-Galveston-Brazoria, TX
Source: Bureau of Labor Statistics and Dallas Federal Reserve
As the Houston economy heated up, so did inflation

Note: Seasonally adjusted. Consumer Price Index for All Urban Consumers: All items in Houston-Galveston-Brazoria, TX
Source: Bureau of Labor Statistics
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Single-family housing construction increased slowly as it faced constraints due to limited lots, labor shortages and wage pressures.

**Single Family Permits**
*(Index Jan2007=100)*

- United States
- Texas
- Houston-The Woodlands-Sugar Land

Note: Seasonally adjusted
Source: Real Estate Center at Texas A&M University
Texas residential construction still below pre-crisis levels

Residential Construction Coincident Index
(Index Jan2007 = 100)

Note: Seasonally adjusted
Sources: Real Estate Center at Texas A&M University & Dallas Federal Reserve
Housing markets expanded even in the face of supply limitations, declining home affordability and tight market credit conditions.

**Existing Home Sales**
*(Index 2007=100)*

- United States
- Texas
- Houston

Note: Seasonally adjusted
Source: Real Estate Center at Texas A&M University
Houston home inventories below 6.5 month. Since last quarter of 2011, at historical low levels...

Months of Inventory
(# of months)

Note: Seasonally Adjusted
Source: Real Estate Center at Texas A&M University
... causing a steady growth in home prices, Houston has seen home prices increase more rapidly.

![Housing Price Index](image)

**Housing Price Index**
*(Index 2007Q1=100)*

- United States
- Texas
- Houston-The Woodlands-Sugar Land

Note: Seasonally Adjusted
Source: Real Estate Center at Texas A&M University.
Houston homes continue to be affordable, although relatively less than the nation.

**Housing Opportunity Index**

(Index)

Source: National Association of Home Builders and Wells Fargo
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Challenges and Issues

1. Falling Oil prices
   - Price of oil has fallen below $50 per barrel
   - Promising significant cuts in domestic oil exploration and drilling (upstream)
   - At the same time major construction boom for petrochemicals and other energy is underway based on cheap natural gas (downstream)
   - Can the construction boom in Houston’s petrochemical provide shelter from the drilling cutbacks?
   - Can growth in the U.S. economy also help?
   - Mismatch between blue collar jobs (downstream) to substitute white collar jobs (upstream): wages and multiplier effect (permanent vs temporary jobs)
Challenges and Issues

1. Falling Oil prices

- Over the long-run, probably half the jobs in Houston are created by the national economy and half by the oil industry.
- In recent years, the growth of shale boom combined with weakness in U.S. economy created considerable disparity.
- Best scenario: a period of moderate growth after years of outsized performance.
- May hide substantial differences between the booming blue-collar east side vs. the white-collar west side that will bear much of the pain.
- Possibly causing slow growth in demand: upscale apartments, office space and high-end retail.
- However, industrial activity will continue to grow strongly: ship channel and/or the machine shops.
Challenges and Issues

Monetary unwinding best way to normalize monetary policy

- Is there an asset market addiction to lax monetary policy?
- Searching for yield in the form of leverage or lower-quality, illiquid assets i.e. “corrosive speculation”
- Disequilibria may build, significant asset price corrections may occur
- Investors may anticipate and act ahead of monetary policy decisions, and asset markets could unwind in a disorderly way
- Authorities in the Federal Reserve should remain alert to burgeoning vulnerabilities
- Goal of monetary policy is to manage exit from low interest rates so economy converges to full employment with stable prices while avoiding financial instability
Challenges and Issues

3 U.S. long-term economic growth prospects

- Medium-term potential growth is forecast to average just above 2 percent for the next several years, significantly below the historic average growth rate of 3 percent.

- Downgrade reflects the effects of aging population and modest prospects for productivity growth.

- Boost long-term growth through:
  - investment in infrastructure,
  - raising educational outcomes,
  - improving tax structure (e.g. corporate tax), and
  - developing and expanding a skilled labor force (immigration reform and job training).
U.S. economy will continue to grow in 2015 while the forecast for Texas suggests moderate expansion

Many, but not all, of the factors slowing the U.S. economy are waning:

✓ Labor market continues to improve

✓ Real estate markets are improving: push for GSEs in making more credit available to homeowners and FHFA will provide banks with more clarity on regulation regarding “put-backs”

✓ Lower oil prices could stimulate further gains in consumer spending

✓ Household balance sheets are better
Moderate 2015 outlook for Texas and Houston’s housing market

1. Employment growth will slow
   - *Dallas Federal Reserve*: Texas 2.5-2.0%
   - *GHP and IRF*: Houston 2.2-1.6%

2. Low mortgage rates

3. Positive home-price appreciation
   - Low inventory levels (supply)
U.S. economy has been characterized by slow growth, uncertainty and now the Texas economy

Some uncertainty continues to pose downside risk to Texas and Houston economic outlook:

✓ Duration of low oil prices
✓ Strength of the U.S. economy
✓ The Federal Reserve’s exit strategy
✓ US shale role of swing producer (cyclical behavior)
✓ Growth in the world economy
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