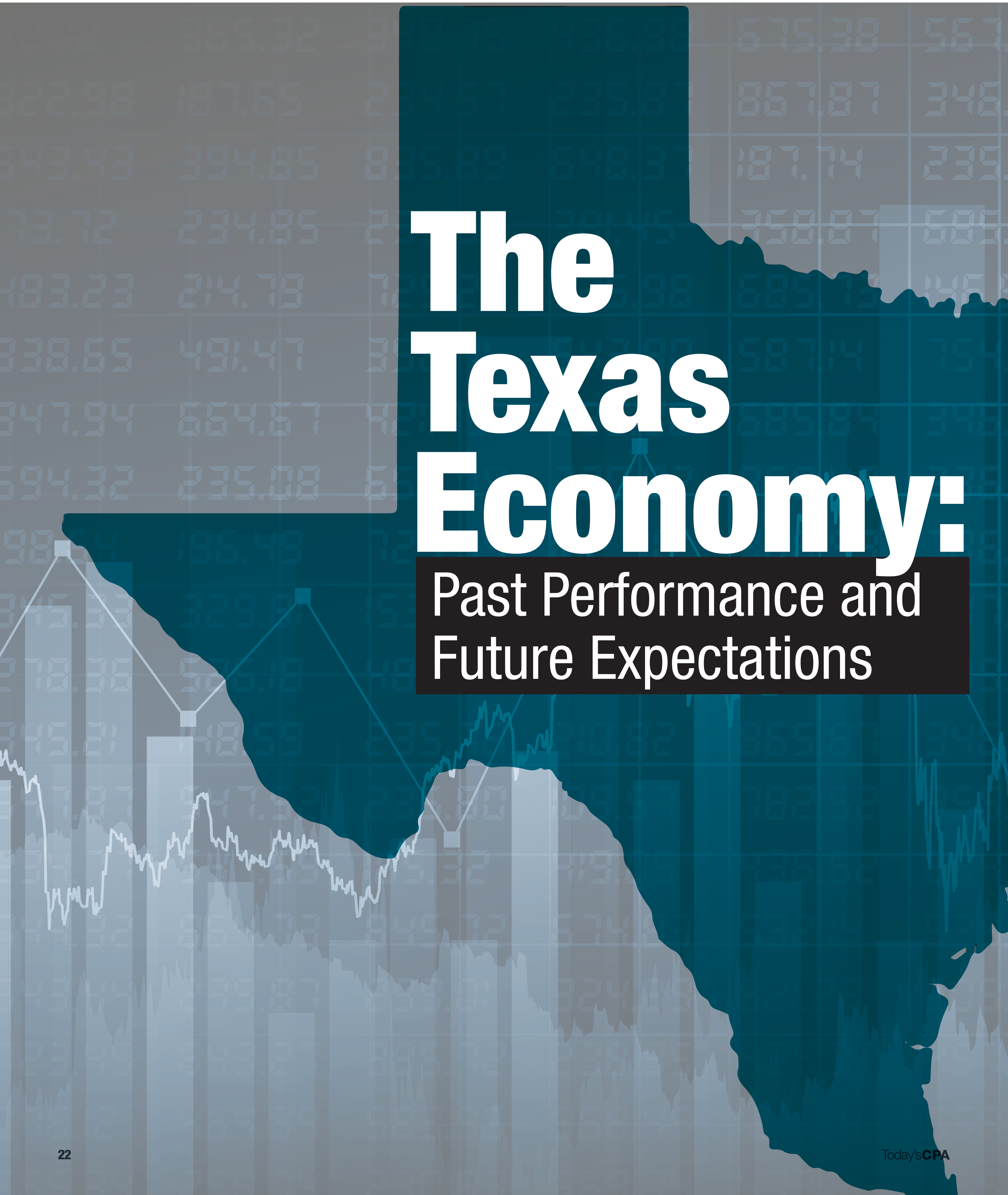

The Texas Economy:

Past Performance and Future Expectations

By M. Ray Perryman, Ph.D.

For a number of years, the Texas economy has been outperforming the nation. In addition to lower rates of unemployment, the state entered the Great Recession later and exited it sooner, avoided the worst of the dramatic real estate market downturn experienced in many areas, and enjoyed better outcomes from economic development efforts. One reason for this strong performance was the substantial boost to business activity associated with the oil industry, which not only benefited from triple-digit crude oil prices, but also implemented new technologies allowing for the unlocking of oil and natural gas in shale formations that had previously been inaccessible. Energy was not the only source of growth, but it was certainly a major one.

Now that the oil surge has ended, at least for the time being, the Texas economy has definitely cooled, but nonetheless continues to expand. Looking ahead, The Perryman Group's latest forecasts indicate economic growth at a moderate pace, with gains across most industrial segments. Following a summary of recent trends and current status, we present The Perryman Group's expectations for the Texas economy.

2015 in Review

Over a period of months in late 2014, the price of crude oil fell from the $80-$100 per barrel range, where it had been trending for several years, to about $40. Through 2015, prices remained in the $40-$60 per barrel range and have fallen even further since that time. As I am writing this article, prices near $30 have been observed, and market forces suggest further downward movement.

As noted, the oil surge was a key reason for Texas' economic strength, with companies and communities across the state benefitting from the entire industry spectrum: drilling to headquarters operations to service companies and everything in between. With the sharp decline in oil prices and resulting scaling back in the industry, the pace of growth in the Texas economy has clearly demonstrated the effects.

Texas added 179,300 jobs during the previous 12 months (November 2014 to November 2015, the most recent data available as we go to press) to reach a total of 11.9 million nonfarm employees in the state. While the economy is creating jobs, the pace of hiring is well below the immediately prior years, when the economy was adding 300,000-400,000 net new jobs per year.

The great majority of the job growth in Texas and elsewhere comes from the services-providing industries, which comprise approximately 85 percent of total nonfarm employment in the state. Specifically, the education and health services sector added 57,600 through November 2015, 48,600 of which were in the health care and social assistance subsector alone. Moreover, the leisure and hospitality sector rose by 54,600 jobs, 92 percent of which were in the accommodation and food services subsector. Large gains were seen in the trade, transportation and utilities sector, with 33,200 additional jobs (mainly driven by a gain of 25,200 jobs in retail trade) and the professional and business services sector with 28,200 additional jobs. Public sector jobs also increased by 20,800 through November.

Where the mining and logging sector added 27,500 jobs in 2014, the sector lost 33,500 jobs in Texas during the first 11 months of 2015. It is estimated that American oil and gas companies have cut over 86,000 jobs since June 2014, and with the price of oil falling still further and low capital budgets among major drilling companies being reported, we may well see further job losses in the industry. However, while rig counts are reaching pre-oil boom levels, the industry has still not seen the level of job loss from the oil bust in the 1980s, when Texas alone lost 240,000 jobs.

The energy sector accounts for a relatively small proportion of jobs in the state (less than 3 percent in oil and gas extraction in related activity), but the positions are typically very high value-added jobs, generating substantial economic activity across a spectrum of industries and exhibiting high "multiplier" values.

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Along with the logging and mining sector, the manufacturing sector took a hit in 2015, with a loss of 35,800 jobs through November (although some strength has been observed of late in some of the technology segments). Employment in the information and construction sectors has remained relatively unchanged, though the number of building permits for single-family homes and multifamily buildings issued over the past year has increased from previous annual totals.

All in all, 2015 was a rocky road for the Texas economy. Even so, the state business complex has proven to be resilient. Despite the losses in the goods-producing sectors, the Texas economy is now much more diversified than in the past, as shown in the growth in services and other sectors. Growth was certainly not robust, but it was a far cry from the collapse that occurred when oil prices plummeted in the 1980s.

Outlook for Oil

Because oil prices (and the resulting level of activity in the energy sector) play a major role in determining the pace of Texas economic growth, the outlook for oil prices is of particular relevance. Currently, the price of oil is far below sustainable levels, but oversupply in the market continues to pressure the price down. This oversupply is largely due to increased U.S. shale production, as well as increased production from OPEC nations as part of a strategy to price out other oil competitors and restore the market share that has been lost in recent years. As OPEC and major U.S. companies have yet to cut production and global demand remains weak, it is likely that the price of oil could continue to fall, though the consensus view at this point (and the most likely outcome according to The Perryman Group's analysis) is that the price will begin to rebound sometime in the latter part of 2016.

Another factor influencing future oil prices is that it is now legal to export crude oil from the U.S. Although it seemed highly unlikely as recently as a few months ago, Congress and the administration have removed the ban on oil exports. For 40 years, it had been illegal to export crude except in certain very limited cases, primarily to Canada. While refined products (gasoline and other fuels, for the most part) were legal to sell into world markets, U.S. companies could not export crude oil without a special license, which was hard (or impossible) to obtain.

As a major oil producing region, Texas stands to benefit from the change, though the effect will likely be modest until global supply and demand shifts and worldwide prices begin to rise in earnest. The spread between oil prices in the U.S. and elsewhere has begun to narrow, and oil produced in Texas has already been sold into world markets.

In addition, removing the ban has had a stabilizing effect on crude oil prices. For example, the recent escalation of tensions between Iran and Saudi Arabia, which would historically have led to a spike in oil prices, had little, if any, effect. The reason for this unusual phenomenon was simply that the market recognizes that any interruptions in Middle Eastern supplies could now be made up by oil from the U.S., an option that had not been available prior to lifting the ban.

As more normal circumstances resume once global suppliers retrench and demand accelerates, domestic producers can expect prices $6-$7 per barrel higher than those that would have occurred with the export ban in place. With improving technology and lower costs, the increment will have a profound long-term impact on prosperity.

Economic Forecast

Many of the major indicators signal that Texas is continuing to outpace the rest of the nation in spite of retrenching in the energy sector. Even with the end of the oil surge, the state added jobs in nine of the 11 months of 2015 for which data is currently available. The Texas unemployment rate has been at or below the national rate for years, and it looks like that pattern will generally be maintained, despite slower hiring in the Lone Star State.

The Perryman Group's most recent short-term forecast indicates expansion in output (real gross product or RGP) at a 4.15 percent annual rate of growth through 2020, although most of the growth is anticipated near the end of the forecast horizon. Texas output is forecast to reach almost $1.9 trillion in 2020, representing an increase of $347.1 billion over current (2015) levels. The large services sector will contribute an estimated $95.1 billion of the total gain through 2020. Annual output in mining (mostly oil and gas) is projected to increase by $51.8 billion over the period, and wholesale and retail trade is likely to account for another $48.0 billion of the total gain. The state's manufacturing sector is also forecast to experience a notable increase in annual output of $47.3 billion.

More than 1.3 million net new jobs are forecast to be added over the next five years, a 2.12 percent compound annual rate of growth. This pace is below that observed during the recent surge, but represents a healthy pattern that is well in excess of that expected for the nation as a whole. About 821,000 of the net new jobs are projected to fall within the services sector, and all major industry segments are projected to experience job gains to some extent over the period.

Looking to other measures of economic activity, The Perryman Group projects that the population of Texas will increase by almost 2.2 million during the next five years to reach 29.2 million. Real personal income is expected to grow at a 4.81 percent annual rate over the period to reach almost $1.5 trillion in 2020. Real retail sales expansion is forecast to occur at a 2.12 percent annual pace, a gain of almost $111.6 billion by 2020. Housing permits are also forecast to increase.

Workforce Preparedness Challenges

One challenge the Texas economy is facing is in the area of workforce preparedness. The Texas Higher Education Coordinating Board (THECB) recently developed a new strategic plan with the overarching goal that at least 60 percent of Texans ages 25-34 will have a certificate or degree by 2030. The 60 percent goal is driven by expectations regarding what the economy and workplace of the future will require, and some well-informed people think that to fully meet the needs of the business complex, we will need to reach 60 percent even sooner.

The 25- to 34-year-old age group was chosen, because it is an indicator of the economic future of the state and its ability to remain globally competitive. The proportion is a large increase from the current level of around 34 percent of Texans in the 25-34 age range who hold associate's or higher degrees. It is important to note that this goal is not limited to individuals earning an associate or bachelor's degree (or higher) through traditional classes at two-year and four-year colleges and universities. For some students, a better path will be earning a certificate in a shorter or competency-based program. Associate degrees can also be earned through dual credit or early college high school programs. Online programs must also play a role.

Another bold aspect of the new strategic plan is that undergraduate student loan debt will not exceed 60 percent of first-year wages for graduates of Texas public institutions. Achieving this goal involves a spectrum of possibilities ranging from controlling tuition costs and promoting more scholarships to helping students make better choices as to how they spend their resources, which could involve anything from finding ways to reduce student costs of living to getting out of school faster by being very efficient with degree plans. It is also going to require increased funding and tangible support of higher education goals and the workforce of tomorrow.

Worst is Over

With the end of the oil surge, the state economy decelerated from its torrid expansion pace, but generally managed to sustain overall growth. Clearly, the current low oil price environment is dampening performance to a significant extent, but it appears that the worst of the adjustment process is over. Moreover, energy has not been the only source of growth in Texas; the state economy was growing nicely even before the energy surge and is unlikely to experience a prolonged setback despite the oil price decline.

A larger challenge to future prosperity is ensuring that young people in the state are obtaining the education and training they will need to succeed and meet the needs of business. Otherwise, long-term prosperity will not be attainable, irrespective of the price of oil and other favorable competitive factors.

The Perryman Group's current forecast indicates that Texas is well positioned for future growth. While the pace may not be up to that of the recent past now that the oil surge has ended, it will nonetheless likely exceed the growth rates observed in many parts of the U.S. ■

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