



The following are excerpts of Texas CEO Magazine's full recap of this informative event which took place in Dallas, Houston, Austin and San Antonio in November 2014. For the full article, please go to www.texasceomagazine.com

With phrases like, "broad based growth," "robust employment" and "Texas will outpace the nation," Mine Yücel, Senior Vice President/Director of Research at the Federal Reserve Bank of Dallas (FRB), kicked off the first of four 2015 Economic Forecast panels.

Yücel sees the likelihood of ending 2014 at a 3.5 percent employment growth rate for Texas while the U.S. rate is forecast to finish up 1.9 percent. Yücel spoke in both Dallas and Austin, and Anil Kumar, Senior Research Economist and Advisor, shared his observations and statistics in both Houston and San Antonio. The forecast events were held at the Federal Reserve Bank of Dallas, the FRB Houston Branch, the FRB San Antonio Branch, and at the AT&T Conference Center in Austin. Collaborators for the 2015 Forecast events were Texas CEO Magazine, Texas Enterprise and the McCombs Alumni Network.

Who's Got the Jobs?

While energy may top all others in sector growth at over nine percent, energy still represents only 2.6 percent of Texas jobs. The highest number of jobs added this year is in the professional and business services sectors with one-third of them in technical and scientific jobs. The next highest sector of growth in jobs was in trade, transportation and utilities, with retail jobs the largest gainer.

The high rate of growth has also led to labor shortages, especially in energy and construction. "We have one Houston contact who reported he was hiring armed guards to keep poachers away from his work sites," noted Yücel. Specifically, there are shortages in specialized workers such as welders, masons, and plumbers and many employers tell Yücel they can't find workers who can pass the Federal background checks.

While one construction sector, road and bridge, is not doing well, residential construction contracts are steadily

growing and up about 6.4 percent year-over-year. “Our contacts are telling us there’s a shortage of developable lots and higher construction costs and labor shortages are limiting growth, and that’s also extended delivery time,” said Yücel.

Yücel cautioned attendees, “These labor shortages aimed at job growth can’t continue at this pace and it’s going to slow as we go forward.”

Energy

With Texas the number one producer of oil & gas in the nation, Yücel reminded everyone, “We don’t only produce oil, we supply the world with oil & gas services with one-quarter of U.S. refining capacity and 60 percent of the petrochemical capacity based in Texas.”

In addition to oil & gas jobs, Yücel noted there are jobs in professional services, construction and manufacturing within the energy sector paying very high wages – the highest wages among all industries – which is bringing significant amounts of income into the Texas economy. In 2012, Midland was the metro with the highest per capita income growth and highest per capita income at \$83,000 – greater than New York or San Francisco.

The price of oil has been tracking downward in the last several months, and while that helps the consumer in gas prices, Yücel cautioned that oil from shale, the kind produced in Texas, is expensive and needs to be at \$70 a barrel to be profitable, so if prices fall below \$70 it will stifle growth in the industry and likely within Texas.

Yücel sees the world economy in a flux and the greatest risks to Texas are the economies of Europe and Asia, along with a labor shortage that will slow our growth rate.

Housing

Shortages of skilled workers and vacant lots for building have caused some bottlenecks in the construction sector, especially for single-family homes, noted Anil Kumar. The result is a reduced supply of homes on the market, with current supply levels sitting at 3.6 months statewide, much lower than the real estate market’s ideal 6-month supply.

This reduced supply has caused increased home prices, reducing the availability of affordable housing. Kumar sees this trend starting to change. “There is some good news,” Kumar said. “It appears the housing price appreciation has started to soften a bit.”

Following the economic crisis, mortgages that are 90-plus days delinquent or in foreclosure reached record highs, but they have been steadily declining and are now nearing pre-recession levels.

Dallas

Engineering & Industrial Construction

In July there was a big jump – including a record high – for construction contract values in Texas.

Construction on the new Dow Chemical plant project in Freeport began, part of a \$4 billion Gulf Coast expansion project being built for Dow by Fluor Corporation. In addition, Exxon has also announced a new plant in Baytown

While there is a bright future in industrial engineering and construction based on pent-up demand, there are two areas of concern for Seaton: comprehensive immigration reform and availability of resources. Seaton said, “We need the immigrants to continue to grow.”

Consumer Package Goods

Focusing on today’s consumer, there are shifts in purchasing based on ethnicity, age, earning power, and most importantly, innovation.

Forty-nine percent of new births in Texas will be Hispanic and that demographic shift impacts how Kimberly-Clark sells Huggies and through what channels.

By 2020, 35 percent of the population of the U.S. will be over age 50. (Kimberly-Clark also sells Depend and Poise products.)

The middle class is being squeezed because income levels are under pressure, real wage growth is minimal, and health care costs are going up.

Falk’s answer to growth is the need to drive real innovation. If you drive meaningful innovation, you can still convert the consumer.

Retail

Retail represents 70 percent of economic spending in the U.S. and it’s the largest employer category in the country.

Fuel prices are low, which is having a positive influence on spending and confidence is high, so there’s a sense of well being.

The next influence to consumer behavior is the AAS factor: Amazon, Apple and Samsung. In 2014, two-thirds of retail sales in the United States were projected to be from those three companies.

Malls are the site of discretionary spending. If you unload the kids at the mall, they disappear into the stores and their spending is on technology.

Malls are global marketplaces. Where there used to be 65 companies operating department stores in various cities in the United States, today there are five or six. It’s all about globalization with companies like Zara and

Mango.

If you're innovative and you recognize the consumer that spends online stays online, and if they spend in the store, they spend in the store," he said. "If you have a customer who spends on both channels, you have a much more valuable, loyal customer.

If retailers can adapt to change, they can succeed.

We operate 900 hair salons because it's very hard to get your haircut online.

Houston

Oil & Gas

Despite lower oil prices, the Federal Reserve says the energy sector is holding steady.

Production in the United States and Canada is on the rise. Producers in the U.S. are spending about \$100 billion a year at current activity levels, with major investments in Texas – primarily South and West Texas. Texas is responsible for about half the projected growth in U.S. production over the next four years.

Production in the U.S. and Canada is 3.5 million barrels of crude a day. In the next four years, it's expected to grow to 3.9 million

The challenge is the quality of the crude. About two-thirds of the 3.9 million barrels a day are going to be medium and light, sweet crude oil and condensate. The majority of the 5.2 million barrels a day we import are heavy and medium sour. There's a quality imbalance here that we have to handle.

The petroleum industry is waiting for guidance from the government because the U.S. is prohibited from exporting light crude. If the government would give us a little bit of clarity, we could expend some capital and handle that. Right now they've gone silent and that's the worst thing because that creates paralysis.

There's a time of volatility coming because the quality of crude being produced doesn't match the quality that most refineries are set up to run but the outcome will be positive. "If you know the storms are coming, you can prepare for them and you know what the outcome is."

U.S. companies spending \$90-\$100 billion a year require capital and "constructive" oil prices. Many smaller producers are spending up to 140 percent of their cash flow and are relying on the capital markets to make up the gap. But even if the price of oil goes down to \$75-\$80 per barrel, many plays can still make a 15 percent return. The real question is: Will the boardrooms and shareholders embrace high spending in a lower price environment? Armstrong anticipates that the quick decline of existing production will trigger higher prices over the next six to 18 months.

If we end up with low prices for a while it won't last long before we have a correction and go right back up. By that time, the world tends to expand demand with lower prices and we'll reset the bar and go forward.

Imports & Exports

Commerce at the port is the strongest in its history, and the port is seeing large construction projects in export cargo.

Our manufacturing partners on the Houston Ship Channel have invested approximately \$35 billion in manufacturing and export capability in the last three years and there is a significant increase in exports of manufactured petrochemical products to foreign markets.

Six major plastic resin manufacturing projects have been announced on the Houston Ship Channel, all coming online between late 2016 and late 2017.

Our petrochemical partners have advised us they expect their exports to double and possibly triple in the next two to three years

Our regional population is growing faster than any other region in the nation and it's expected to double and even triple in the next 20 to 30 years. Regional population growth drives consumer demand, which in turn drives demand for products delivered as containerized cargo.

We're already the leading Gulf Coast port handling 66 percent of containerized cargo. Because of our strategic location and our population reach, we will be the beneficiary of significant additional cargo across our docks with the expansion of the Panama Canal.

The Port of Houston is investing a billion dollars over the next five years in both dredging and infrastructure. Refrigerated cargo is also a potential growth area.

Health Care

One area not directly affected by the oil industry is health care. The Greater Houston Partnership says population growth will add 7,900 doctors and nurses to the employment rolls in 2014. The future is bright for large hospitals.

I don't think the future is bright for small hospitals in small towns. As incentives and rewards in health care change, hospitals will be forced to deliver the highest quality product at the lowest price with the best customer service.

Now, hospitals are being held accountable for such metrics as patient mortality and length of hospital stays.

The big institutions like the ones in the TMC with healthy balance sheets that are forward looking and innovative, have gotten the message and are shifting from fee for service to value-based operations.

Robbins said his biggest challenge is getting all of the institutions that make up the Texas Medical Center to work together on interdisciplinary projects.

Austin

Technology

There's an opportunity on the horizon that revolves around the rapid reshaping of the industrial economy –

where access to technology is going to fundamentally change the dynamics for the U.S. and many countries around the world.

Hydraulic fracturing's cutting-edge technology has solved an industrial problem.

The industrial Internet of Things with its ability to have time synchronized networks, real time operating systems that leverage mass computing power, and the ability to have encrypted wireless communication in high volume, is going to fundamentally change the way the industrial economy works. The industrial Internet of Things is only now taking shape and will have a macro effect on the economy requiring the appropriate investments.

The United States is the biggest market in the world for just about everything and has tremendous amounts of natural resources, so manufacturing and production shouldn't be leaving our shores.

Daven listed three challenges in being more competitive: the execution of manufacturing and competing with low cost labor from other countries, access to talent, and the taxation environment in the U.S.

Davern predicts more industrial and manufacturing jobs returning to the U.S. as the cost of labor becomes more expensive in the rest of the world and the evolution of technology continues. He said if companies can increase the efficiency of labor and production over a wide variety of products in switching to U.S.-based production, we will fundamentally reshape the U.S. economy.

NI will attempt to hire 250 new engineers and computer scientists in 2015 – and they are hard to find.

Immigration policies requiring international students to return to their original countries after graduation are one reason for the talent scarcity.

The U.S. is the second least competitive tax environment in the industrial world – only France is worse.

We have to reshape the industrial economy of the U.S, apply technology to the problem, which takes engineers, and we have to attract the capital and encourage it to remain onshore. If those three things get done, there's no reason why the U.S. can't remain the number one economy in the world.

Real Estate

While sales in Texas were down in 2014 versus 2013, it has been a good year for real estate. Most of the decline is due to a reduction in distressed property sales along with a reduction in available affordable housing. Talbot expects a strong real estate year in 2015.

Gains in real estate prices in Texas continue to outpace the U.S. National year-over-year price gains are expected to run between four and six percent; comparatively, Texas gains will reach between 6 and 10 percent.

Inventory is tight. Dallas and Houston saw price increases up eight and nine percent, respectively, last year. Austin's real estate is the least affordable in the state.

Mortgage rates are the most important topic in the real estate industry. Rates may drop below 4 percent

again, which would further spur the real estate market.

Student loan debt quadrupled between 2003 and 2014, and first-time home buyers are waiting to pay down student loans before they are able to enter the real estate market. These increased loans can dramatically affect millennials' ability to purchase homes

Multi-family permits are up more than 30 percent this year, while single-family permits are up 8 percent.

Permits in Austin are starting to slow down, while the market waits to see if new construction can be absorbed. Single-family permits are starting to rise again, mostly in the suburbs and xburbs.

Electricity and Water

The new Ferguson Power Plant, a combined-cycle natural gas plant, has 30 to 40 percent lower emissions and uses 35 percent less fuel than the plant it replaced.

LCRA is also heavily invested in coal generation and is working through the EPA's guidelines to curb emissions.

LCRA's reservoir system is at 34 percent, which is a good number considering the extent of the drought.

Water consumption has decreased in Austin due to raised awareness and sensitivity around the drought.

Finding new water supplies is difficult due to increased construction costs, extensive legal frameworks and complicated permitting. Currently ground water is mostly treated as a private resource but regulated locally.

Most districts will only grant five-year ground water permits. Regulations need to be restructured to make the most of these resources.

By the end of this year, Hofmann expects the LCRA to break ground on its first new reservoir since the 1950s.

LCRA is also moving to take its Bastrop power plant off surface and onto ground water to preserve supply.

San Antonio

Financial Services

Low interest rates have pros and cons for those in financial services. Current low rates don't cause problems for those businesses offering credit at high rates, but can be detrimental to businesses' balance sheets if the cost of credit rises or spikes.

A sharp rise in interest rates would be detrimental to business. Roberts cited Europe's current economic situation as an example of what could happen in the U.S. due to recent volatility in the markets.

Those who are at or near retirement want to see interest rates go up to get more out of their savings and fixed instrument investments because without an increase in rates, retirement is going to be more challenging.

Currently life insurance ownership is at a 50-year low in the U.S.

The busiest areas for USAA are in the digital and mobile spaces. "We will do \$500 million in transactions on mobile devices this year." Robles suggested that the business world adjust to meet the needs of millennials

and move to newer ways of doing business or younger customers and employees will choose to go elsewhere.

On the fraud security front, there is a new technology in the U.S that's been used extensively in Europe, called chip and PIN that embeds a chip in all credit cards and requires a PIN to use. This chip provides better security to credit and debit card owners to reduce fraud and theft

BioTechnology

Biomedical provides one out of every six jobs in San Antonio with more than 40,000 jobs gained in the sector in the last 10 years.

The biomedical center accounts for \$29 billion in economic activity and is the largest economic center in the city

Trevett expressed concern over federal cutbacks on R&D spending. The National Institute of Health's purchasing power has gone down 25 percent over the last decade. San Antonio does not have abundant jobs available to new Ph.D.s in the area with research facilities, since many companies do not do much hiring during the research phase of R&D.

Private Equity

The private equity market is currently seeing its highest IPO activity since 2007. Committed capital is over \$500 billion right now, which is an amazing number.

Purchase price multiples for companies in the sub-\$250 million of enterprise value are at their highest level in more than 10 years. We have strong debt markets, with debt to EBITDA at 2.5 and sub-debt at 3.7 times, which is the highest in 10 years. There's also plenty of money for making deals with the cash balances of strategic acquirers at \$1.3 billion.

There are four key areas of focus: automotive, retail, energy, and real estate

The transportation sector makes for solid investing due to consolidation that allows for greater equity from those companies, which hasn't been available for the last few years.

The current low cost of capital allows for more innovation and product creation.

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