The Impact of the Oil Price Collapse on Texas Business

How Long Will It Last?

By Alan Lammey

There's no doubt that businesses in the Lone Star State are concerned about the health of the Texas economy since one of the largest components of the state's revenue is under big duress from a commodity price that has plunged more than 60 percent since last summer. This sector is also a big employer for our state. Of course, we're referring to Texas' oil and natural gas industry. However, as tenuous as the situation may seem, there are some bright spots for businesses and consumers to consider while the local economies wait for oil prices to make their inevitable rebound.

It's no secret that Texas is a global leader in the energy industry, and Houston is widely known as the Energy Capital of the World. Dallas and Midland follow closely behind in terms of the large amount of revenue that's derived from the oil and gas business. While there's all sorts of doom and gloom naysayers in the media espousing how the recent collapse in oil prices may create long-term negative impacts on the local economies throughout the state, essentially comparing it to the floundering Texas economy of the 1980s, the bottom line is that the Texas economy is now far more diverse and much less dependent on oil revenue than it was back in the 1980s. In fact, in 1982, taxes on oil and gas production accounted for just over 17 percent of state revenue, while in 2014, the share was just 5.5 percent. Assuming other areas of the Texas economy perform well in 2015 as indicated by several economic projection models, the oil industry's trials and tribulations might be a sizeable economic sore spot, but it's not likely to have nearly the sort of negative economic impact on the Texas economy and local businesses that occurred in the 1980s.

Oil Prices Have a History of Big Volatility

Oil prices have had a history of major volatility since the 1980s, and whenever major swan dives have transpired in oil prices over the years, the Texas oil and gas industry manages to rebound much faster and stronger each time. For example, when West Texas Intermediate (WTI) crude oil prices skyrocketed to nearly $150 per barrel in July 2008, prices literally cratered within 5 months, bottoming out at a low of $37.58 per barrel on December 26, 2008. That's a whopping 74 percent decline, and the doom and gloomers were out in full force at that time. However, 8 months later, oil prices climbed back to about $70 per barrel and stayed in a roughly $70 to $80 range until early 2011. Oil prices kept on climbing toward the $100 per barrel area by March 2011 and have essentially oscillated between about $90 and $110 a barrel until July of 2014. Since then, prices have subsequently fallen back down to around $44 in January 2015.

While it's true that the U.S. oil and gas industry is struggling financially, as any industry would if their revenue was slashed in half, there are several Texas industries that are actually benefiting from the lower energy costs. For the everyday American consumer, it's estimated that for every 1 cent reduction in the price of gasoline at the pump, about $1 billion is spent in other areas of the general U.S. economy. As such, the cost per gallon of gasoline that was well above $3 per gallon early last summer rapidly tumbled to $2 or lower per gallon in the last several months. That sort of drop has added a large boost to consumer spending for all kinds of various products and services. When it comes to Texas businesses, there are actually many industries that are coming out winners amid the plummet in oil prices including airlines, restaurants, retailers, truckers, freight companies, and numerous consumer products, which are all benefiting from the reduced commodity price to operate their businesses. Plus, if the regression in oil and fuel cost continues to persist, it could equate to another $200 billion added to the overall economy that would normally have gone toward paying for auto fuel.

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Lower Oil Prices Have Bright Spot, Jobs is Not One of Them

The downside from the employment perspective, at least for Texas, is the very good paying jobs that are generated by the oil and gas industry typically outweighs the smaller benefits of the lower commodity price on the local economies. After all, jobs in factories, retail, restaurants, etc. typically pay notably less than the jobs offered by the energy industry as well as the industries that serve the oil and gas business.

What's more, not all industries outside the oil and gas industry are happy with the major fall in oil prices, particularly when it comes to alternative energy and renewable energy projects. This is because the cheap price of oil, natural gas, and various refined products makes other alternative energy products much less competitive and desirable.

Interestingly enough, from a historical perspective, almost every time oil prices have fallen steeply over the last three decades, the overall stock market and key sectors flourish. For example, in the past 25 years, with few exceptions, when oil prices plunged, stock market prices rose during the oil price decline and immediately after the decline. In fact, during the last two bull stock market runs that were associated with oil price declines, the two stock market major industry sectors that gave investors the best and most consistent performance were health care, up an average of 60 percent, and technology, up an average of 64 percent. Meanwhile, after oil prices bottomed in the last two bull stock market runs associated with oil price declines, 12 months *after* oil prices hit their lowest point, the best performers were technology, up 35 percent in addition to the 64 percent rise they enjoyed *during* the oil price decline, and consumer discretionary spending, up 24 percent. During this *current* oil price decline, technology and consumer discretionary spending have once again been among the top performers in the markets.

What Goes Down Will Come Up Again

Looking ahead, the combination of technical, fundamental, psychological, and geopolitical indicators suggest that oil prices will rebound later in 2015, potentially when the seasonal driving season ramps up in the spring around April or May. Furthermore, the current low price of oil is bringing new oil and gas production projects to a screeching halt. Therefore, it won't be long before the over-abundance of supply that has contributed to the recent meltdown energy prices will begin to dry up later in 2015. In a nutshell, it would not be out of the question to see oil prices rise back in the $60s or even perhaps notably higher in months ahead. **N**

Alan Lammey has 17 years' experience as a senior energy markets analyst and journalist best known for his forward-thinking energy market analysis. He can be reached via www.TexasEnergyAnalyst.com or alammey@TexasEnergyAnalyst.com.