

INGHAM ECONOMIC REPORTING

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February 3, 2014

The Midland Development Corporation And Security Bank

Present

The Midland-Odessa Regional Economic Index and the Texas Permian Basin Petroleum Index December/4th Quarter/Annual 2013

The Midland-Odessa Regional Economic Index posted another strong increase in December to wrap up another year of strong growth in the Midland-Odessa combined metro area economy. The index rose by another full point in December to 116.8 up from 115.8 in November, and up 6.5% from the December 2012 MOREI of 203.6. That marks the fourth straight year of extraordinary growth in the Midland-Odessa economy, and the 46th consecutive month of increase in the Midland-Odessa Regional Economic Index. Fourth quarter growth was stout as well, with the index increasing by just under 1.5% over the quarter for an annualized growth rate of 5.8%.

Since the recession of 2009 came to an end (the Midland-Odessa Regional Economic Index bottomed out in February 2010), the index has grown by over 55%. Annual economic growth over this four-year period of time has averaged over 13%.

The Texas Permian Basin Petroleum Index, an ongoing measure of regional oil & gas activity, ended the year with the 49th consecutive increase, marking an astonishing period of expansion fueled by favorable crude oil prices and rapid technological advancement. The continued growth in 2013 was characterized by an average crude oil price (West Texas Intermediate) of about \$94.50, a steady rig count, a flat to slightly lower drilling permits total, and ongoing industry employment growth.

But the story of 2013, both regionally and statewide, is the dramatic increase in crude oil production. We have revised the production estimate process to reflect the likely production total after future revisions to production data by the Texas Railroad Commission. In other words, production is always higher – often significantly higher – than the original estimates put forth by the Railroad Commission, and the current crude oil production estimates contained in this report (on the data table for the Texas Permian Basin Petroleum Index) are much more likely to match the ultimate production totals after the data is revised in future months. After a nearly 15% increase in 2012 over 2011, the volume of crude oil produced in RRC districts 7C, 8, and 8A was up by an estimated 13.7% in 2013 compared to 2012. Estimated crude oil production in 2013 was up by a whopping 50% compared to the 2005 annual total, the trough year of crude production before the turnaround began in 2006.

The activities of production, drilling, and service companies that are bringing about these fantastic increases in production are also driving general economic growth across the region and in the Midland-Odessa combined metro area. The 2013 economic year featured record levels for virtually every component of the Midland-Odessa Regional Economic Index, with the exception of the number of homes sold and the metro area unemployment rate (which may well reach record low levels during the current expansion).

General real (inflation-adjusted) taxable spending was up by 8% for the year in 2013 compared to 2012; compared to the recession year of 2009, general spending in 2013 was up by over 60%, which again simply indicates the enormity of the expansion that has taken place during that four year period of time. The fourth quarter total was a record as well, and was up by 7.3% compared to the fourth quarter 2012. Compared to the same period in 2009, fourth quarter real spending was up by an incredible 88%.

Auto sales actually posted a slight decline for the quarter (after year-over-year growth rates of 42%, 38%, and 20% in the fourth quarter of 2010, 2011, and 2012, respectively), but finished the year in record territory with inflation-adjusted spending on new and used automobiles up by 2.3% compared to the 2012 annual inflation-adjusted total. Since the recession of 2009, inflation-adjusted automobile spending in the Midland-Odessa metro area has more than doubled, with the 2013 annual total up by 111% compared to 2009.

Construction in the metro area set a record – by a lot – in 2013, surpassing \$1 billion in building permit valuations for the first time ever (that \$1 billion was actually achieved in September), and outpacing the 2011 annual total – also a record at the time – by over 70%. Fourth quarter building permit activity was very nearly double the fourth quarter 2012 at over \$271 million.

The number of new single-family residence construction permits in Midland-Odessa has surpassed 1,000 in a calendar year only twice, in 2012 and 2013. The 2013 annual total set a new record at 1,333 permits issued, an increase of over 16% compared to the 2012 annual total. The fourth quarter total was up by only about 5%, but surpassed 300 for the first time (for the fourth quarter).

And those homes are sorely needed in the metro area housing inventory to help relieve some of the pressure to any degree possible on the housing market. Housing prices tell us everything we need to know about that market, with the average home sale price in 2013 up by another 8% compared to 2012 at over \$226,000. The fourth quarter average home sale price was up by over 6% compared to the fourth quarter 2012, which in turn was up by 16% compared to the fourth quarter of the prior year.

The number of homes sold in 2013 was flat compared to the 2012 sales total, though sales have certainly been on the rise since taking a nosedive in 2009. Clearly more homes would be sold in the metro area absent the considerable (and related) restraints of availability and price. There simply are not enough homes available to meet current demand, and of course rapidly rising prices has the effect of pricing a number of potential buyers out of the market.

Even though the number of home sales in 2013 is not a record (it is down compared to each year 2005-2007), the total dollar volume of residential real estate activity is easily at record levels in 2013. The actual dollar volume of nearly \$290 million is up by over 8% in 2013 compared to 2012; when adjusted for inflation, the total real dollar volume of activity is up by over 6% compared to 2012, and is up by over 30% compared to the pre-recession peak year of 2007 (and again, the number of sales was actually higher in 2007).

Employment growth in the metro area averaged nearly 6% higher on average compared to 2012, and at year-end 2013 was up by nearly 5% with another 7,800 jobs added over the last 12 months. Since the

recession year of 2009 about 41,000 jobs have been added to the Midland-Odessa economy, and expansion of about 33% over that period of time. Post-recession employment growth rates in Midland-Odessa have been the highest of any metro area in the nation, and the unemployment rate is among the lowest in the country and remains the lowest in Texas.

While there are revisions yet to come in some 2013 data (most notably, the employment data for 2013, and perhaps 2012, will be revised over the course of the next couple of months), there is simply no doubt that the Midland-Odessa economy was again an impressive, stoutly growing, high-performing economy in 2013. And momentum remained strong at year-end moving into 2014.

When the revised payroll employment information is released in early March, we will fashion a more complete forecast for the balance of the year 2014 at that time. However, in large part the course of the year will be charted based on crude oil prices and the resulting levels of oil & gas activity across the region. At present, few are predicting higher crude oil prices in 2014, though there are relatively few credible forecasts that call for catastrophic declines in crude prices. The 2013 average was in the mid-\$90 range/bbl – the 2014 crude price could very plausibly be some \$5-10 lower than that simply based on the remarkable increases in production (supply) during a time of lackluster growth in demand due to US and global economic conditions. That is, of course, what “high” prices in freely functioning markets are designed to do – stimulate production and discourage consumption. The production increases, of course, have been nothing short of remarkable, but again could easily bring about lower prices in the future, as one might expect.

And every incremental decrease in the price of crude oil will in turn have some corresponding effect on activity levels as some projects become uneconomic and are set aside in favor of lower cost projects. While it may not turn out to be the case, it makes sense to prepare for a corresponding flattening of general economic activity in the Midland-Odessa metro area. That ‘flattening’ would occur at a very high level of activity, however, and that is a generally favorable outcome.