

INGHAM ECONOMIC REPORTING

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The Midland Development Corporation And Security Bank Present

The Midland-Odessa Regional Economic Index and the Texas Permian Basin Petroleum Index September/3rd Quarter 2014

The Midland-Odessa Regional Economic Index continues to expand at a rapid pace through September increasing to 226.0 up from 224.5 in August, and up 6.9% from the September 2013 MOREI of 211.4. The rate of growth has actually gained momentum as the year has progressed, and in fact the annualized rate of growth in the index in the third quarter was a stout 8.5%.

The Texas Permian Basin Petroleum Index, a monthly measure of the regional oil & gas exploration and production economy, is also increasing a faster pace through September, rising to 374.2 up from 370.4 in August and up 11% from the September 2013 TPBPI of 337.2. The monthly average rig count remained above 460 (for Texas RRC districts 7C, 8, and 8A), and the 1,402 drilling permits issued in September is the highest monthly total on record. The September monthly estimate for oil & gas related employment in the Midland-Odessa metro area is up over 13% compared to September of a year ago.

Third quarter 2014 general economic numbers are nothing short of fantastic with sharp growth in most components of the index, with the exception of home building which is down compared to high numbers from a year ago.

Inflation-adjusted spending per September sales tax receipts in Midland-Odessa is up by nearly 19% compared to September of a year ago, and is over 13% higher in the third quarter. For the year-to-date, general real spending is up by over 11% compared to the first nine months of a year ago. Real auto spending is up by over 20% for the month and quarter, and is up by over 16% for the year-to-date.

Construction activity exploded in the third quarter, and in September in particular during which building permit valuations totaled over \$235 million aided considerably by new school construction in Odessa for nearly \$140 million. The \$525 million in third quarter building permit values represents the highest third quarter total on record by far, and is up by over 25% compared to the third quarter 2013, which in turn was up by 68% compared to the third quarter of the prior year.

The rate of employment growth has also gained momentum throughout the year, and the 5.8% rate of year-over-year employment growth is the highest thus far in 2014. Through the first six months of the year, the rate of payroll employment growth averaged 3.8%, and averaged about 5.4% in the third quarter. The Midland-Odessa metro area unemployment rate fell below 3% again in September after typical seasonal increases over the summer. And unlike virtually all other Texas metro areas, the Midland-

Odessa unemployment rate is now below the prior unemployment rate low point achieved in 2008 in advance of the 2009 recession.

As spectacular as the numbers are in both the general metro area economy and the regional oil & gas economy, that is not the story of the day. The monthly average crude oil price for September, below \$90/bbl and down 13% year-over-year, has fallen considerably more since then (and of course prices received by Permian producers are generally discounted considerably off of that posted price). The current posted West Texas Intermediate crude oil price below \$80/bbl – in fact, \$77.00/bbl today (Friday, October 31) is indeed the story of the day because it suggests that a change to this extraordinary growth pattern may be in the offing.

A decline of 25% in crude oil prices will affect activity levels to some degree, and about this there should be no doubt. The numbers remain impressive through September, but the coming months will almost certainly bring about rig count decline, a decrease in the number of drilling permits issued, and so on. The depth and duration of price decline will determine the nature of the contraction, and that in turn will determine the nature of the effect to the general economy of the region and the metro area. Typically the impact to the Midland-Odessa economy is observed on a lag time of anywhere from three to six months on the heels of a peak in the regional oil & gas index. And, of course, through September the regional oil & gas index has yet to peak – but we should expect that to happen in 2014.

Will this be a deep decline in activity resulting in a significant general economic contraction? At roughly \$75-80/bbl, probably not, though again, Permian producers on balance are not presently receiving the full posted WTI price. At posted prices below \$75/bbl, the regional E&P economy changes dramatically, I suspect, and certainly a posted WTI price below \$70/bbl results in a dramatic retreat in regional oil & gas activity. The coming few months will tell the story, but for now I think we are safe in predicting a peak in the Texas Permian Basin Petroleum Index and an observable decline in activity levels in the short term.