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
December/4th Quarter/Annual 2014

The growth in the Midland-Odessa Regional Economic Index in December capped off another fantastic year of growth in the Midland-Odessa combined metro area economy. The MOREI improved to 232.3 in December up from 230.4 in November, and up 8.4% from the December 2013 index of 214.2. The general economic numbers for December, the fourth quarter, and the year 2014 as a whole were spectacular, with only the construction-related indicators down compared to high (and record) numbers in 2013.

Even the annual regional oil & gas numbers look good with crude oil averaging nearly $90/bbl, the rig count near its all-time high, a record number of drilling permits, increases in the volume and value of production, and strong growth in industry employment to new record levels.

And yet none of that is the story as we finish the year 2014 and move into 2015. Since June of 2014 the price of crude oil has been steadily and sharply on the decline and at its worst was down more than 60% compared to its June peak. The regional oil & gas industry began to respond to those declining prices in November with a sharp decline in drilling permits, and the rig count began to fall in early December. The Texas Permian Basin Petroleum Index peaked in October and declined in both November and December and will continue to do so as it chronicles the industry contraction now underway. The next domino to fall will likely be regional and metro area oil & gas industry employment, and then in the coming few months the general economic numbers in Midland-Odessa will begin to register the impacts of the downturn in oil patch activity. The Midland-Odessa Regional Economic Index will probably peak during the first quarter of 2015 (and if not then, no later than early in the second quarter) and begin to decline as well.

Even if prices were to turn the tide and begin to recover immediately, the stage is still set for a deep oil & gas industry contraction and all of the associated effects simply based on what has already *happened*.

So, what are the likely effects of the oil & gas upstream industry contraction in 2015 (or over the course of the cycle)? The 2008-09 downturn and the resulting impacts provides direction in terms of forecasting the outcomes this time around. While future events could possibly mitigate some of these possibilities, these are the likely outcomes and it is those for which we should be prepared.

- The regional upstream oil & gas economy as represented by the Texas Permian Basin Petroleum Index will probably decline by some 35-40%.
- The regional rig count (we track the rig count for Railroad Commission Districts 7C, 8, and 8A) stands to fall by 60-70% from its November peak of 467 -- in other words, 2/3 of the working rigs will probably be lost over the course of the contraction, and perhaps more (in 2009 the rig count actually fell by nearly 75%). As of last Friday the rig count had already fallen by 20%, a decline of 95 rigs since November.
- Oil & gas employment in the Midland-Odessa metro area will likely decline by 20-25%, losing perhaps 8,000 direct jobs just in the metro area alone (and obviously the numbers would be higher region-wide).
- The general economy of the combined Midland-Odessa metro area as represented by the Midland-Odessa Regional Economic Index will probably decline by at least 10% over the course of this full cycle. The contraction was much deeper than that in 2009; however, the US and Texas economies also endured a full-blown recession which helped to deepen the local recession. It is possible, of course, the decline could be steeper simply because the oil & gas industry makes up such a sizable share of the metro area general economy.
- The Midland-Odessa metro area stands to lose about 17,000 jobs in total, and again that number could be higher depending on the depth and duration of the contraction.

Are these guaranteed outcomes? No. The results could be some better or some worse depending on oil price movements and the timing of those movements in the future. However, the results were quite similar in 2008-09 with a deep but short-lived decline in crude oil prices and a rapid recovery thereafter. There is certainly reason to suspect the nature of crude oil price recovery may not be so favorable this time around.

The tendency during times of contraction in Midland-Odessa and the Permian Basin is to focus on the cycles of expansion and contraction (or “boom and bust” as people tend to characterize it – terms I’m not that fond of). And it is true that the oil-based economy is simply more volatile than most other economies in Texas or anywhere else in the nation for that matter. But what is also true is that the regional oil & gas economy has blessed the region with higher net growth – MUCH higher net growth – over time compared to any other economy in Texas and beyond. Over the course of the expansion now coming to a close the Midland-Odessa general economy grew at an average annual rate of about 13% per year. Over all the history of the Midland-Odessa Regional Economic Index, which is based in January 1996, the economy has grown by an average 7.5% per year. Would residents and businesses in Midland and Odessa trade the volatile cycles for much lower rates of net economic growth given the choice? I am not the one to answer that question, but it is a question worth asking.