

# InghamEcon, LLC

*Karr Ingham*

P.O. Box 7531  
Amarillo, TX 79114

(806) 373-4814  
karr@inghamecon.com

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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 June/2<sup>nd</sup> Quarter 2015**

Data issues and revisions continue to result in some minor alterations to the Midland-Odessa Economic Index, and the index updated through June reflects these revisions. Most notably the labor force/unemployment rate data for Midland and other Texas metro areas was revised dating back to at least 1990, which of course encompasses the entire history of the Midland-Odessa Regional Economic Index. Additionally, there were some minor revisions to the Consumer Price Index data used to apply an inflation adjustment to the applicable components of the index.

Under the current data benchmarks the Midland-Odessa Regional Economic Index peaked in January 2015 at 236.1 and has declined each month thereafter through June. The monthly declines in February, March, and April were quite mild, but the margin of monthly decline has begun to widen in May and June as the contraction begins to gain a bit more momentum. The June 2015 Midland-Odessa Regional Economic Index dipped to 234.2 down from 234.9 in May, but still remains 5.4% higher compared to the June 2014 MOREI of 222.2.

Over the course of the second quarter 2015 the Midland-Odessa Regional Economic Index declined at an annualized rate of 2.3%, and declined at an annualized rate of 1.1% over the first half of the year. Since peaking in January, the index is off by only about .8% through June; however, logic certainly dictates continued decline in 2015 in response to lower crude oil prices and the resulting regional industry contraction. And in fact crude oil prices have now taken another significant dive after recovering to as high as \$58/bbl (daily posted WTI price) in June.

The Texas Permian Basin Petroleum Index lost another 10 points in June falling to 317.6 down from 327.7 in May, and down 13.4% from the June 2014 index of 366.7. The Texas Permian Basin Petroleum Index peaked in October at 381.1, and is down by about 17% through June compared to that peak. (These numbers are also subject to ongoing revision due primarily to updated regional production data for crude oil and natural gas.)

Midland-Odessa economic indicators are mixed – though mostly negative – through midyear with declines in general taxable spending, auto spending, construction, housing construction, and residential real estate sales. Hotel/motel numbers remain in positive territory but the current data only reflect activity through the first quarter (second quarter numbers will be included in the July analysis). And employment

growth remains in positive territory according to current monthly estimates, though the rate of year-over-year growth is narrowing with each passing month.

General real (inflation-adjusted) taxable spending was down by 8.6% in June compared to June of a year ago, and second quarter real spending was off by 2.5% compared to the second quarter 2014 total. Spending remains in positive year-over-year territory for the year-to-date but that will change as the year progresses, of course.

Auto sales are taking more of a beating, however, with inflation-adjusted spending on new and used vehicles down by 24% in June, 20% in the second quarter, and 14% for the year-to-date compared to the same time periods in 2014.

Both general spending and auto spending were at peak levels in 2014 and were sharply improved compared to the prior year, so current-year figures are being compared to numbers that were at the peak of an extraordinary growth period last year.

The construction figures are not final (the city of Midland is in the midst of a software change for the reporting of building permit data) but the preliminary estimates along with Odessa's numbers certainly indicate that construction activity is down compared to the high levels of building activity last year and the year before. New single-family housing construction permits were higher for the month (compared to a year ago), but down for the quarter and for the first six months of the year.

Housing sales activity is down by varying degrees across the board – the number of sales, the price of those sales, and the real (inflation-adjusted) total dollar volume of residential real estate sales activity. The number of homes sold in Midland and Odessa is down by about 11% through the first six months of the year, and by about 4% for the quarter. June monthly housing sales were down by 8% compared to June of a year ago, which in turn was up by over 18% compared to June of the prior year.

The average price of those sales is down only very slightly compared to some very high numbers from a year ago. The second quarter average sale price in Midland-Odessa was down by only 1.5% compared to the second quarter of a year ago; however, the second quarter 2014 average was up by over 15% compared to the prior year. The average for the first six months of 2015 is down by a scant 1.3% compared to the January-June 2014 average, which in turn was up by over 14% compared to the first six months of the prior year. In other words, home prices in the combined metro area remain at very high levels with little relief thus far as a result of the slowdown now underway. That may well happen over time but the housing market in Midland-Odessa has been under stress for a number of years now and the solution to the problem of high home prices is not a quick one.

The inflation-adjusted total dollar volume of home sales activity is predictably lower thus far in 2015 based on changing economic circumstances, but again that is primarily due to a lower number of sales, not lower prices. The slight reduction in demand very likely has as much to do with high prices as it does a slowing economy and air of uncertainty as a result of the transition brought about by low oil prices.

The employment numbers are finally beginning to reflect a slowdown in year-over-year growth rates on the way to what will almost certainly be employment decline before all is said and done. Estimated direct oil & gas employment in Midland-Odessa remains in positive year-over-year territory but that margin of growth has narrowed to about 1% in June, down from over 11% as recently as February of this year. Total payroll employment in Midland-Odessa is up by 4.3% -- still relatively high under the circumstances but down from rates of growth exceeding 8% in January and February of this year. And again, the combined unemployment rate for Midland-Odessa has reversed course and is now slowly on the rise.

The crude oil price path in recent months is of interest – as prices declined in the last six months of 2014 and on into the first quarter of 2015 the daily posted (offered to producers) price for a barrel of West Texas Intermediate crude oil fell to as low as \$40.00 in March. The rig count followed suit, finally breaking in the late November and December before falling by about 60% both in Texas statewide and in RRC districts 7C, 8, and 8A (the Texas Permian Basin). Price then began to recover, reaching as high as \$58.00/bbl on June 10. The rig count followed suit and began to rise in Texas and in the Permian, and continued to increase even through last Friday.

The clear signal to producers of a systematic and dramatic decline in price is to lower production. There should have been no expectation that there would be a meaningful reduction in production until sometime in the second half of 2015, because that is historically the lag time between a drop in price and a corresponding shift in production trends (though there was the theory that shale production would drop much faster). For a variety of reasons, the sheer amount of crude oil produced is typically the last domino to fall. However, crude oil prices seemed to rise simply based on the reduction in the rig count, drilling permits and other measures of activity rather than on a reduction in production.

Through the first six months of 2015 estimated crude oil production in the US was up by about 13% compared to the first six months of 2014. In Texas, crude oil production through June was up by a whopping 18% in Texas and in the Texas Permian Basin.

Crude oil in storage in the US has risen in the first half of 2014 and midway through 2015 is up by about 8% compared to crude oil stocks in June 2014. OPEC production is on the rise, particularly in Saudi Arabia and Iraq, and the market is also dealing with the prospect of Iranian crude oil making its way into the global marketplace as a result of the nuclear weapons deal that would permit the marketing of crude oil from Iran.

In other words, the current crude oil price outlook is bearish, not bullish, and the market is coming to the same conclusion as evidenced by the fact that posted WTI crude oil prices have now fallen below \$40/bbl. What seemed like something to celebrate – some measure of price recovery and a corresponding uptick in the rig count – is in fact no reason to celebrate at all simply because in no way as the market been cleared and supply and demand returned to some semblance of balance. So, it seems as though the market is simply suggesting that prices may have to go yet lower – or remain at current low levels – to *force* a decline in production (supply). Time will tell whether current levels of production are sustainable at current prices – I don't happen to think they are. Again, we had little expectation of a meaningful change in production trends from growth to decline until the second half of 2015, anyway, and there are reasons companies would do everything possible to maintain production at a high level for as long as possible. But that can't last forever, and production will ultimately respond by peaking and beginning to decline. If that doesn't happen, then we had all better settle in for a long period of relatively low crude oil prices.

The rate of production growth through June of this year is still somewhat shocking, however, and it seems apparent at this point that crude oil production in Texas in 2015 will set a new record, surpassing its previous all-time record established in 1972. The market mechanisms setting crude oil prices from day to day have no idea whether the current high level of production is temporary – only that it is the case now, and we should be prepared for a punitive move downward in price in response to elevated levels of production and the uptick in the rig count.

The short-term – and perhaps longer term – economic implications in Midland-Odessa depend on these outcomes. Crude prices that are “lower for longer” (the emerging mantra) point to a longer term slowdown in the metro area economy. At this point the Midland-Odessa economy is only five months into what has thus far been a very mild contraction. There is little doubt that the economy will continue to register contraction at a faster rate in the coming months, particularly based on current crude oil prices and the move below the \$40 threshold.