



2020 MAY  
**Midland &  
Permian Basin  
Economic Index**



The

**Perryman Group**

Effective economics, accessible analysis

1.800.749.8705 | [info@perrymangroup.com](mailto:info@perrymangroup.com) | [www.perrymangroup.com](http://www.perrymangroup.com)

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## OVERVIEW

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The May Perryman Midland and Permian Basin Index values were down, but stabilized to some extent compared to April.

The inevitable result of measures to “flatten the curve” and prevent a major spike in COVID-19 infections has been a strong shock to the economy. Many factors will determine the ultimate effects of the coronavirus, including the outcomes of reopening the economy and the capacity of businesses to resume normal activities.

In Midland and the Permian Basin, the pandemic’s effect on oil markets has caused a strong drop in activity in the industry and, thus, the area economy. The price decline is due to the combination of (1) plummeting demand as economies and industries around the world shut down due to COVID-19 and (2) rising supply, with threats of even more due to the collapse of talks earlier this year among major global oil producers to try to bring discipline to the market. An agreement was subsequently reached which brought notable reductions in daily production, but not as large as the drop in consumption across the globe. Markets have stabilized recently.

Although production costs are down sharply in Texas, they are not yet at a level to maintain broad-scale activity at current prices. As a result, the situation is leading to significant disruptions in the Permian Basin and the state’s other production areas. The industry has engaged in a rapid shutdown of drilling activity, which ripples through an enormous supply chain and supporting retail and service enterprises in the affected communities and the rest of the state. Banks which have large energy company loan portfolios are being strained, and mid-stream and downstream investments are being deferred. Adverse effects on oil producing areas are being observed in a dramatic fashion, but the fallout from the situation involves all regions of Texas.

As the economy begins to recover from COVID-19 restrictions and travel prohibitions, oil markets can normalize expeditiously. Prices are already trending toward more normal levels and should recover to sustainable levels for West Texas producers (where costs were falling notably for years before the pandemic) in the next few months.

Although comparisons are being drawn to the horrific events of the 1980s, the situation at that time was very different. Key differences include (among others) the speed of the downturn, the underlying structural problems in the economy that were present at that time, and the contrast between the 1980s’ declining reserves and rising costs and today’s expanding reserves and falling costs. The near-term situation in oil markets is undeniably severe, but it is a temporary aberration stemming from an unprecedented health issue. As the economy reopens, demand for oil will rise and markets will normalize. This is NOT the 1980s.

The effects of the COVID-19 pandemic began to be felt in March and were causing dramatic decreases in April. In May, some industries began to recover, but the increases were much smaller in general than April’s losses.

Results are summarized in the following pages, with additional detail in the accompanying workbook.



## MIDLAND MSA

The Midland Economic Index decreased over the past month from 96.5 to 90.1, a smaller drop than April's -20.0. Even with this decline, the Index remained above the levels experienced in 2016.

The Energy industry experienced losses of -9.2 in May, notably smaller than April's -21.9. Hospitality & Tourism experienced some recovery, up 17.1, but the increase was much smaller than April's drop of -57.9. Construction continued to fall (down -6.8), after a drop of -48.9 in April. Retail was up slightly, but far less than April's decrease of -25.6.

## MIDLAND MSA ECONOMIC INDEX

RECENT RESULTS (2012=100)

|                            |           |
|----------------------------|-----------|
| Current Index Reading      | 90.1      |
| Change from Previous Month | Down -6.4 |

## MIDLAND MSA ECONOMIC INDEX

RESULTS BY INDUSTRY (2012=100)

| Industry                         | April       | May         | Change      |
|----------------------------------|-------------|-------------|-------------|
| Energy                           | 83.4        | 74.2        | -9.2        |
| Construction                     | 127.9       | 121.1       | -6.8        |
| Manufacturing                    | 122.9       | 116.3       | -6.6        |
| Retail                           | 103.9       | 108.1       | +4.2        |
| Financial Services               | 218.4       | 218.0       | -0.4        |
| Real Estate                      | 153.0       | 159.9       | +6.9        |
| Professional & Business Services | 115.8       | 114.4       | -1.4        |
| Health Care                      | 90.0        | 88.3        | -1.7        |
| Hospitality & Tourism            | 87.9        | 105.0       | +17.1       |
| Other Activity                   | 130.2       | 137.0       | +6.8        |
| <b>Midland Composite</b>         | <b>96.5</b> | <b>90.1</b> | <b>-6.4</b> |

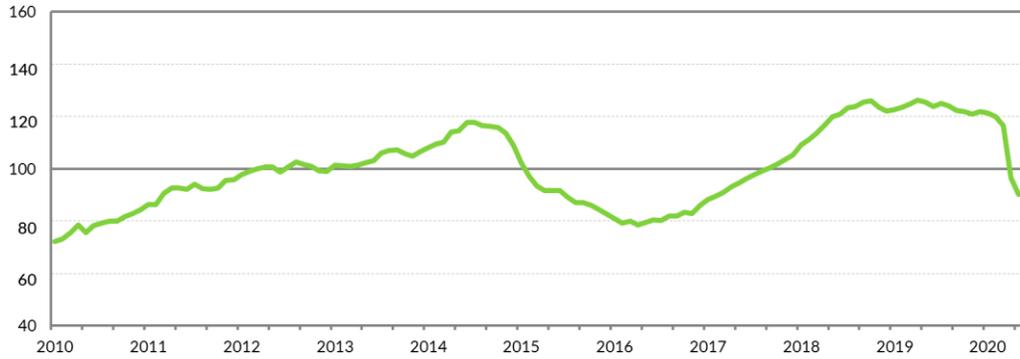
**Note:** Industries are not weighted equally in calculating the Industry Composite; see the Appendix for further explanation. The Midland Metropolitan Statistical Area (MSA) includes Midland and Martin counties.

**Source:** The Perryman Group



### Midland Economic Index

(Index adjusted such that 100 represents economic status in 2012)

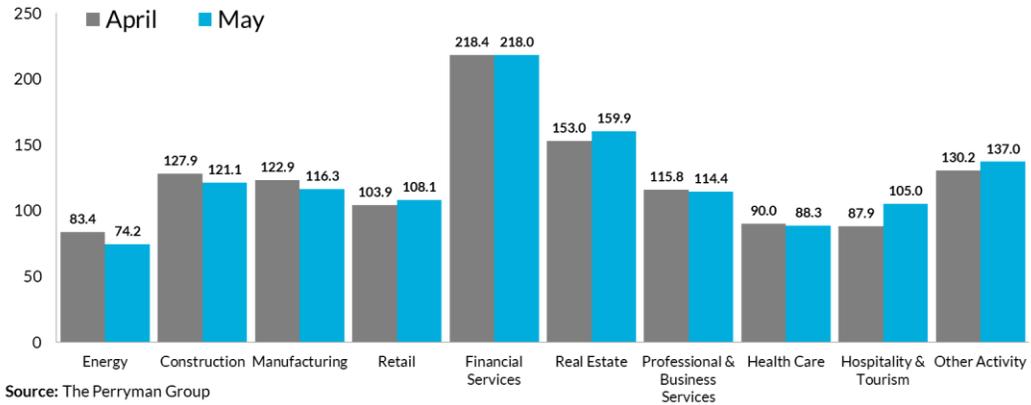


Source: The Perryman Group

### Midland Economic Index

Recent values by sector

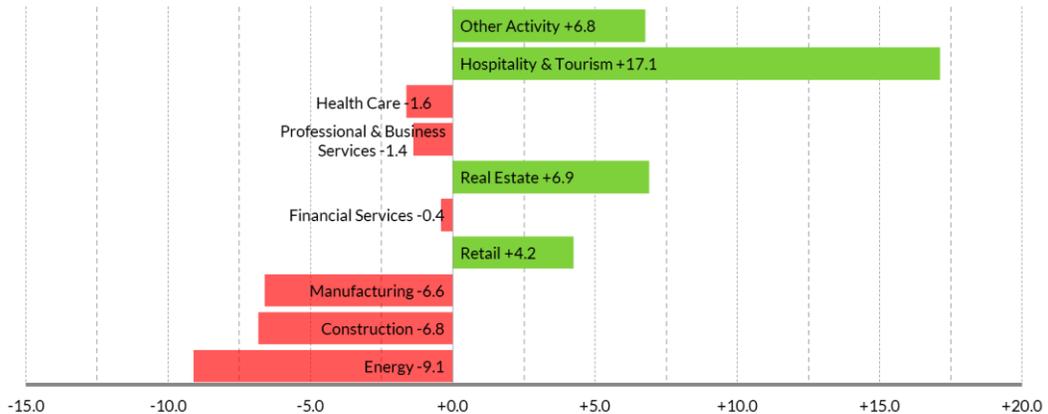
(Index adjusted such that 100 represents economic status in 2012)



Source: The Perryman Group

### Midland Economic Index

Change from previous month by sector



Source: The Perryman Group



## PERMIAN BASIN REGION

The Permian Basin Economic Index decreased over the past month from 97.6 to 96.0, stabilizing to some extent in May after a decline of -19.5 in April.

The Energy industry declined significantly, continuing a downward trend which began early this year. Hospitality & Tourism and Construction increased, but the improvement represents only a partial recovery of the strong drops in April of -59.3 and -53.6, respectively.

## PERMIAN BASIN ECONOMIC INDEX

RECENT RESULTS (2012=100)

|                            |           |
|----------------------------|-----------|
| Current Index Reading      | 96.0      |
| Change from Previous Month | Down -1.6 |

## PERMIAN BASIN ECONOMIC INDEX

RESULTS BY INDUSTRY (2012=100)

| Industry                       | April       | May         | Change      |
|--------------------------------|-------------|-------------|-------------|
| Energy                         | 74.8        | 68.7        | -6.1        |
| Construction                   | 110.4       | 117.5       | +7.1        |
| Manufacturing                  | 113.3       | 107.3       | -6.0        |
| Retail                         | 104.3       | 109.0       | +4.7        |
| Financial Services             | 218.6       | 218.2       | -0.4        |
| Real Estate                    | 155.4       | 161.2       | +5.8        |
| Professional & Business        | 102.7       | 100.6       | -2.1        |
| Health Care                    | 91.1        | 89.2        | -1.9        |
| Hospitality & Tourism          | 84.1        | 99.5        | +15.4       |
| Other Activity                 | 125.7       | 132.1       | +6.4        |
| <b>Permian Basin Composite</b> | <b>97.6</b> | <b>96.0</b> | <b>-1.6</b> |

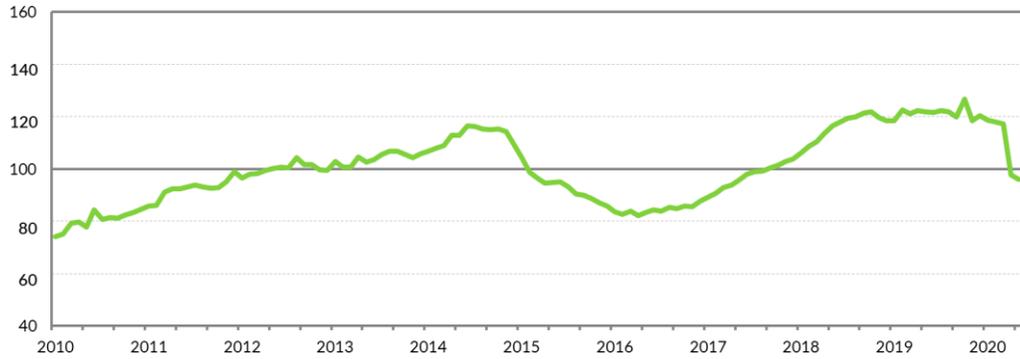
**Note:** Industries are not weighted equally in calculating the Industry Composite; see the Appendix for further explanation. The Permian Basin Region includes Andrews, Borden, Crane, Dawson, Ector, Gaines, Glasscock, Howard, Loving, Martin, Midland, Pecos, Reeves, Terrell, Upton, Ward, and Winkler counties.

**Source:** The Perryman Group



### Permian Basin Economic Index

(Index adjusted such that 100 represents economic status in 2012)

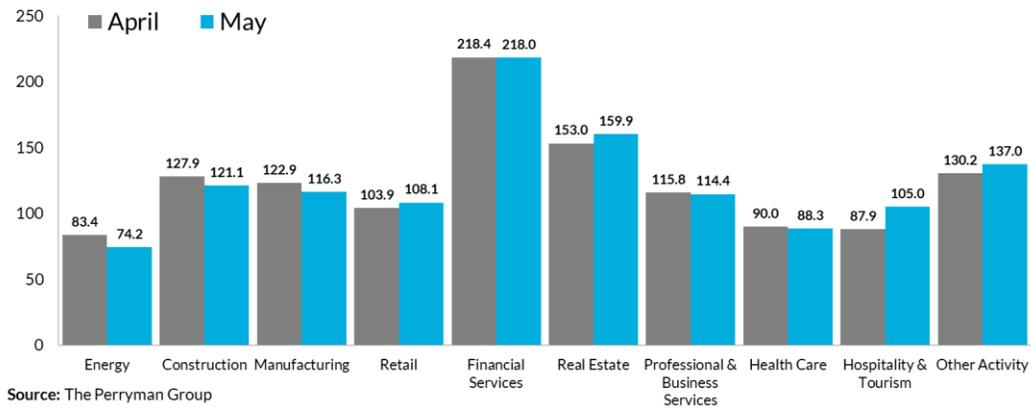


Source: The Perryman Group

### Permian Basin Economic Index

Recent values by sector

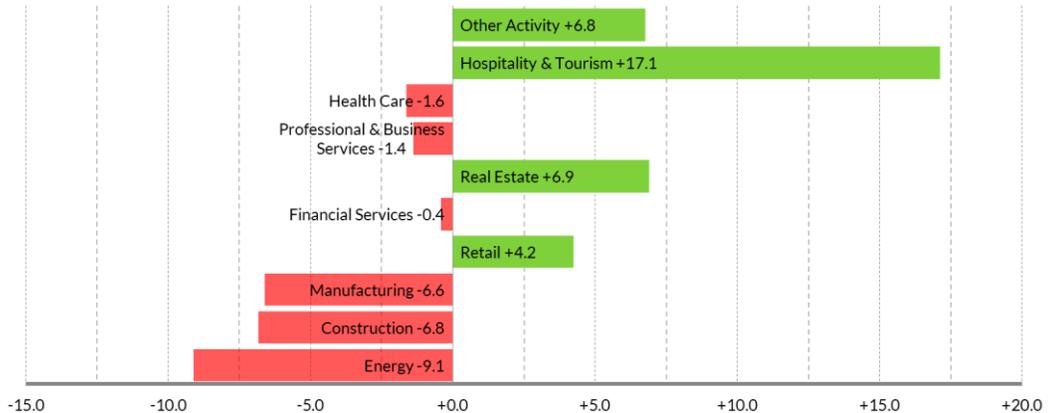
(Index adjusted such that 100 represents economic status in 2012)



Source: The Perryman Group

### Permian Basin Economic Index

Change from previous month by sector



Source: The Perryman Group



## METHODOLOGY

The goal of the Midland and Permian Basin Index is to encapsulate, in a single measure, the current status of the local and regional economy, how it is changing, and what is driving the change. The Index includes measures of industrial performance, with sub-indices for the various components to indicate the role they play in overall performance. The Index is based on complex economic modeling processes, but it provides a simple measure of the health of the local and regional economy and how and why it is changing.

The Index reflects shifts in key industries and performance. The relative weights of each component were determined based on typical patterns in the relationships of variables to overall economic performance. The Index includes variables ranging from oil prices to construction which describe the evolving status of key industries. These measures reflect analysis of numerous indicators of the level of activity and how it is changing.

The Midland and Permian Basin Index was developed and is maintained by The Perryman Group, an economic and financial analysis firm based in Waco, Texas with decades of experience in analyzing the local and regional economies. Dr. M. Ray Perryman, President and CEO of The Perryman Group, has more than 40 years of experience in index construction and regional economic modeling. In particular, Dr. Perryman derived the indices of monetary policy that are used by the Federal Reserve System and more than 60 other central banks around the world. He also developed regional and small-area indices of Industrial Production and Unit Labor Costs that are widely

used on a global basis, as well as measures of systematic risk for non-homogenous assets and the degree of trade integration among nations. Dr. Perryman has been an advisor to the US Department of Labor on the Consumer Price Index as well as numerous other governmental entities on index-related issues. He has also developed the world's largest regional econometric modeling system and has been analyzing the economy of Midland and the Permian Basin on an ongoing basis since the mid-1970s. The firm produces a quarterly index for a major financial firm in the state.

### Index Construction

Economic indices are typically constructed in one of two ways, both of which are widely used and have been successfully employed by Dr. Perryman over the course of his career. One common method is to identify a set of relevant variables and then use principle component analysis (PCA) or a variation (such as a factor rotation) to assign weights to the individual components on an empirical basis. In essence, this process converts a set of variables into an equal number of new measures such that each of the new variables is (1) a linear combination of the original ones and (2) orthogonal to each of the others. The new measures also have the property of collectively containing all of the information in the original variables. When this approach is used, the first principle component (the one which explains the largest percentage of the variation) is typically used to determine the weights in the index. This approach has advantages in that (1) weights are empirically generated based on their explanatory power and (2) it is relatively simple to implement. Its

major disadvantages are (1) in many instances, particularly where a large number of variables are being examined (as in the current analysis), spurious correlations with relatively minor factors that are unlikely to be sustained over time can occur; (2) the first principle component, despite exhibiting the largest explanatory power, often accounts for only a small amount of the total variation, thus failing to incorporate a substantial portion of the available information.

The second approach is to rely on economic data, theory, and models to develop an index of the desired phenomena. The primary difficulty with this method is the fact that it can become complex in its execution. The advantages are the ability to (1) systematically incorporate very large sets of variables without loss of underlying information, (2) develop sub-indices to provide a focus on specific index elements, and (3) incorporate specific economic content in a detailed and systematic manner.

In the present instance, the second option appeared to be more appropriate in that the process included the incorporation of a complex multi-dimensional framework which allows both individual and integrated consideration of a variety of segments that span multiple sectoral components. Nonetheless, a principle components model was originally attempted for purposes of completeness and to meet the conditions for statistical efficiency. As anticipated, the resulting assessment across a broad spectrum of variables across industries resulted in both weighting on relatively minor variables which were not stable across sub-periods and relatively little (less than 10 percent) information capture by the primary principle components.



Consequently, the Midland and Permian Basin Index was developed using a more formal and comprehensive data and modeling effort. This process is described below.

### **Industrial Variations**

As noted, the Index seeks to encapsulate, in a single measure, the many facets of the local and regional economy. Sub-indices are also generated for key industries in order to examine the various components and the role that they play in overall performance. Aggregates available on a monthly basis are incorporated into the Index in order to permit regular monitoring of changes in business activity. Broader measures (such as total expenditures and gross product by industry) which have greater information content but less frequent periodicity are used in defining the relative weights. In this manner, it is possible to enhance the comprehensiveness of the Index.

The segments of the economy that are included in the Index are:

- Energy,
- Construction (residential and non-residential),
- Manufacturing,
- Retail,
- Financial Services,
- Real Estate,
- Professional & Business Services,
- Health Care,
- Hospitality & Tourism, and
- Other Activity

The relative weights to be applied to each segment were derived based on the stabilized percentage

of each sector of a relevant overall aggregate (gross area product).

The next phase of the analysis is the construction of the various sectoral indices. Measures that were available on a monthly basis were employed and were selected based on their role in being reflective of aspects of the relevant segment. They were then tested relative to one another to assure that they were not subject to excessive multicollinearity. Once the final set was determined, each quarterly series was transformed into a common format in which 2012 was defined as equal to 100. The base year is consistent with most official economic series that are presented either as indices or on a constant-dollar basis. All monetary values were similarly expressed in constant 2012 dollars to avoid artificial growth generated by inflation. In a few instances, quarterly series were converted to monthly aggregates using a regression approach developed by Dr. Perryman that is widely utilized throughout the world.

The variables utilized in the Index include items such as oil and gas prices, rig counts, retail sales, single and multi-family housing permits and values, housing sales and values, bank loans and deposits, employment by detailed industrial category, and numerous other factors. Where appropriate, inputs were adjusted to eliminate seasonal patterns that are not reflective of underlying economic conditions.

In each of the indices, the weights assigned to the individual components are determined based on the relative standard errors of the normalized values. This approach allows greater weight to be assigned to those measures which exhibit more pronounced fluctuations to influence industry performance. These individual

sectoral indices were aggregated into an overall Composite Index using the weighting described above. Separate individual sectoral measures and Composite Index values were generated for the Midland Metropolitan Statistical Area and the Permian Basin Region. It should be noted that the monthly indices always use the latest available economic data. Because much of the information normally is subject to both short-term revisions and periodic benchmarking, historical values will often change from month to month. These variations are typically minor.

### **Historical Performance**

Historical performance of components of the Midland and Permian Basin Indices is provided in the accompanying workbook.

### **Conclusion**

The Midland and Permian Basin indices provide a measure of changes in the economy that is easy to grasp and compare over time. Although the modeling process that went into the indices was complex, the result is a simple and straightforward assessment of the direction of patterns in business activity and the reasons for changes in overall performance.



# THE PERRYMAN GROUP



The Perryman Group is a focused team of analysts who know how to address complex economic information tasks and present our findings effectively.

Our in-house professionals bring expertise in economics, finance, statistics, mathematics, real estate, valuation, systems analysis, engineering, technical communications, and marketing. Dr. Ray Perryman, President and CEO, has 40 years of experience in developing systems, analyzing complex problems, and communicating effectively. We have considerable pride in what we do. Our enthusiasm is both unbridled and contagious; every day brings a new opportunity for us to tackle a different problem or create a product or service specifically tailored to our clients.

## OUR SERVICES

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We are at the cutting edge of econometrics and other advanced statistical methods and have provided innovative approaches for many complex applications.

### SPEECHES

Dr. Perryman addresses dozens of audiences throughout the world every year, catering to a wide variety of events.

## M. RAY PERRYMAN, PH.D.

Dr. Ray Perryman is President and CEO of The Perryman Group, an economic research and analysis firm based in Waco, Texas. His firm has served the needs of more than 2,500 clients, including two-thirds of the Global 25, over half of the Fortune 100, the 12 largest technology firms in the world, 10 US Cabinet Departments, the 9 largest firms in the US, the 6 largest energy companies operating in the US, and the 5 largest US banking institutions.

Dr. Perryman was named Outstanding Young Person of the World for Business and Economic Innovation in 1987, was designated Texan of the Year by the Texas Legislative Conference in 2012, received the Baylor University Distinguished Service Medal in 2013, was inducted into the Texas Leadership Hall of Fame in 2014, received the Cesar E. Chavez Conscience Builders Award in 2016 for his humanitarian efforts, the 2019 Chairman's Award for Lifetime Achievement in Economic Development from the International Economic Development Council, and the 2019 "Go Global"

Award for Economic Analysis from the International Trade Council. He dedicates a significant portion of his time to pro bono work aimed at helping to solve pressing social problems such as hunger, indigent healthcare, poverty, and child maltreatment.

