U.S. and Oklahoma Economic Outlook

Broken Arrow Chamber of Commerce
May 4, 2016

Chad Wilkerson
Vice President, Economist, and Oklahoma City Branch Executive
Federal Reserve Bank of Kansas City
www.kansascityfed.org/oklahomacity
Structure and Functions of the Federal Reserve System

- The “Fed” consists of three main entities:
  - Board of Governors: 7 members appointed by U.S. President
  - Federal Reserve Banks: 12 total; semi-independent by design
  - Federal Open Market Committee: 19 members; 12 voting

- As with most central banks, the Fed’s primary responsibilities fall within four general areas:
  - Lender of last resort – provide liquidity in times of crisis
  - Monetary policy – promote full employment and low inflation
  - Bank regulation – ensure safety and soundness of banks
  - Financial services – bank for banks, bank for federal govt.
The Oklahoma City Branch of the Federal Reserve Bank of Kansas City

- **Functions** – approximately 40 staff
  - Research on U.S. and Oklahoma economies
  - Economic, community, and financial education outreach
  - Examinations of Oklahoma financial institutions

- **2016 Branch Board of Directors**
  - **Pete Delaney (chair)**, Chairman (retired), OGE Energy Corp., OKC
  - **Clint Abernathy**, Owner, Abernathy Farms, Inc., Altus
  - **Michael Coffman**, CEO, Panhandle Oil & Gas, Inc., Oklahoma City
  - **Chuck Hall**, Chairman & CEO, Exchange Bank & Trust, Perry
  - **Jane Haskin**, President & CEO, First Bethany Bank & Trust, Bethany
  - **Tina Patel**, Co-Owner & CFO, Promise Hotels, Tulsa
  - **Doug Stussi**, EVP & CFO, Love’s Travel Stops & Country Stores, OKC
The U.S. Economy and Monetary Policy
U.S. business activity has slowed slightly, but job growth remains solid.
U.S. unemployment is at long-term levels after falling considerably in recent years.
U.S. inflation is low but expected to return to close to target in 2016

PCE Inflation Index

Current (Q1 2016): 1.0%
Current Core (Q1 2016): 1.7%

Mar. FOMC Forecast Ranges in Yellow

Percent change, year-over-year

Sources: U.S. Bureau of Labor Statistics, FOMC
FOMC participants expect moderate increases in rates heading forward

Federal Funds Rate
Year-end target

Current (May 2016): 0.50%

Sources: Federal Reserve Board, FOMC
Trends in the Oklahoma Economy
Job trends have varied somewhat across Oklahoma the past couple of years.
Energy jobs have plummeted, but spillover to other industries has been relatively limited

Job Growth by Industry
Mar-16

Percent change, year-over-year

Source: Bureau of Labor Statistics
With many workers finding jobs in other industries, unemployment still remains low.
In related news, banking conditions in the state have remained good.
But declining tax receipts are creating difficulties for government budgets.

State Tax Receipts
Through Q2-16*

OK Sales Taxes
OK Total Taxes

Q3-06 Q1-08 Q3-09 Q1-11 Q3-12 Q1-14 Q3-15

*Note: Q2-16 through April 2016

Source: OK Tax Commission
New home construction plans have leveled off as the economy has slowed

Source: U.S. Census Bureau
Office vacancies in Oklahoma’s 2 big metros are beginning to rise but remain modest.

Office Vacancy Rates

Source: TWR
The outlook for the energy sector remains key across the state

Oklahoma Personal Income Share by Industry
State - 2014, Metro/Non-Metro - 2012

<table>
<thead>
<tr>
<th>Industry</th>
<th>OK Location Quotient</th>
<th>OK % of Total Income</th>
<th>OKC Location Quotient</th>
<th>OKC % of Total Income</th>
<th>Tulsa Location Quotient</th>
<th>Tulsa % of Total Income</th>
<th>Non-Metro Location Quotient</th>
<th>Non-Metro % of Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>8.1</td>
<td>14.8</td>
<td>8.3</td>
<td>14.4</td>
<td>7.8</td>
<td>13.6</td>
<td>7.2</td>
<td>12.5</td>
</tr>
<tr>
<td>Farming</td>
<td>1.8</td>
<td>2.0</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Federal Government</td>
<td>1.3</td>
<td>5.8</td>
<td>1.8</td>
<td>8.6</td>
<td>0.4</td>
<td>1.8</td>
<td>1.7</td>
<td>8.2</td>
</tr>
<tr>
<td>Construction</td>
<td>1.1</td>
<td>6.4</td>
<td>1.0</td>
<td>5.7</td>
<td>1.3</td>
<td>7.3</td>
<td>1.0</td>
<td>5.8</td>
</tr>
<tr>
<td>Trade, Transp. &amp; Utilities</td>
<td>1.1</td>
<td>16.1</td>
<td>1.0</td>
<td>14.6</td>
<td>1.2</td>
<td>18.8</td>
<td>1.0</td>
<td>15.0</td>
</tr>
<tr>
<td>State &amp; Local Government</td>
<td>1.0</td>
<td>13.0</td>
<td>0.9</td>
<td>12.1</td>
<td>0.6</td>
<td>7.7</td>
<td>1.4</td>
<td>19.6</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>0.9</td>
<td>9.4</td>
<td>0.7</td>
<td>6.8</td>
<td>1.3</td>
<td>13.3</td>
<td>1.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Education &amp; Health</td>
<td>0.8</td>
<td>10.7</td>
<td>0.9</td>
<td>11.7</td>
<td>0.9</td>
<td>11.5</td>
<td>0.7</td>
<td>9.4</td>
</tr>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>0.8</td>
<td>3.5</td>
<td>0.9</td>
<td>4.1</td>
<td>0.7</td>
<td>3.0</td>
<td>0.7</td>
<td>3.0</td>
</tr>
<tr>
<td>Prof. &amp; Business Services</td>
<td>0.6</td>
<td>10.8</td>
<td>0.7</td>
<td>12.6</td>
<td>0.8</td>
<td>13.1</td>
<td>0.4</td>
<td>6.7</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>0.6</td>
<td>6.0</td>
<td>0.8</td>
<td>7.3</td>
<td>0.8</td>
<td>7.3</td>
<td>0.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Information</td>
<td>0.5</td>
<td>1.6</td>
<td>0.5</td>
<td>1.8</td>
<td>0.7</td>
<td>2.3</td>
<td>0.3</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Note - Location quotient is the division of local share by national share

Source: U.S. Bureau of Economic Analysis
The Outlook for the Energy Sector
World oil supply and demand are expected to remain out of balance for some time.

Source: EIA, Chicago Mercantile Exchange
Increasing declines in U.S. production help, but uncertainty in OPEC does not.

Change in World Oil Supply
Since U.S. Peak and Forecast

Q1-16 to Q4-16 (March Forecast)

Q1-16 to Q4-16 (April Forecast)

World
U.S.
OPEC
Other

Source: EIA
According to firms, profitable prices for oil (and natural gas) are above current prices:

- Oil Price Needed for Profitability in Active Areas:
  - Q3-14: $79
  - Q1-15: $62
  - Q3-15: $60
  - Q1-16: $51

- Price Needed to Increase Drilling Significantly:
  - Q2-15: $73
  - Q4-15: $60

- 2016 Year-End Expected WTI Price:
  - Q3-15: $70
  - Q4-15: $58
  - 2016: $50

- Natural Gas Price Needed for Profitability, Q1 2016: $3.28 average

- 2017 Year-End Expected WTI Price:
  - Q1-16: $60
  - 2017: $56

Source: FRBKC Energy Survey
The KC Fed’s Q1 energy survey showed further declines, with more expected.
Summary

• The U.S. economy continues to grow, and the Fed has begun to raise interest rates

• Oklahoma employment and tax revenues continue to suffer from the oil downturn

• But unemployment remains low, and there has been fairly limited spillover so far

• The energy sector remains oversupplied, and thus may be a drag for some time