Texas is shifting from an oil state to a gas state

THE TEXAS PETROLEUM economy was strong and thriving in 2003, with oil and gas prices continuing their high levels at the end of the year. Drilling permits issued in Texas were up in 2003 from 2002 as was the rig count by a significant amount. Oil patch employment was down slightly from 2002, however. In the end, it appears that Texas is shifting from being an oil state to becoming a natural gas state.

A monthly index compiled by the **Texas Alliance of Energy Producers**, which represents approximately 2,000 members in 233 cities in 17 states, stood at 141.3 at the end of 2003, which was only the sixth time that the index has exceeded 140 in its nine year history. That is an 18% growth in the petroleum economy since the end of 2002.

The index is designed to measure growth and cycles in the state's oil and gas production economy and is a composite reflection of a comprehensive group of production-related indicators. The Petroindex, as it is called, is based at 100.0 in January 1995. It is presented as a partnership effort of the Texas Alliance of Energy Producers and the **Wells Fargo Energy Group**.

Figures compiled by the group indicate that Texas is on its way to becoming a natural gas state.

"I think the state is solidly in the midst of a transformation from an oil producing state to a gas producing state," said **Karr Ingham** with **Ingham Economic Reporting**, which helps compile the index.

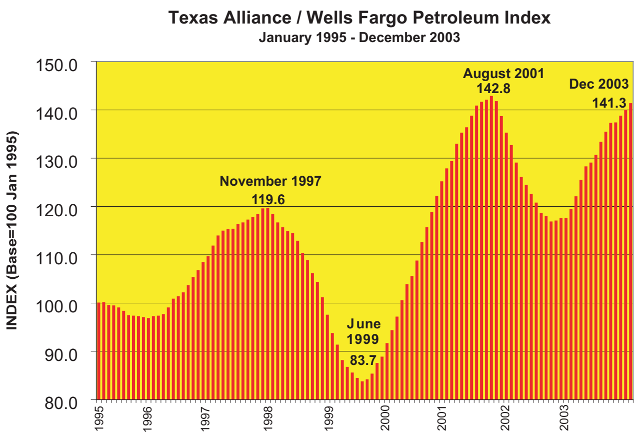
He said oil production from the time the index was first compiled to the end of 2003 declined by a "staggering" 30%. "There is simply 30% less oil pulled out of the ground now and sold than there was at the beginning of (1995)," he said.

"That decline is going to continue, I suspect, unless something miraculous occurs and the world of technology can somehow turn that around."

Natural gas production during the same period declined 1-2%, and that may even turn around. "We may actually begin to see some growth in gas production in the coming months," Mr Ingham said.

COMMODITY PRICES

Monthly posted oil prices averaged $27.80 per barrel during 2003, the highest annual average since the index's inception. That compares to $22.83 per barrel in 2002.



The Petroindex at year end 2003 posted an 18% increase over the year earlier period. The index measures growth and cycles in Texas' oil and gas production economy and is a composite reflection of a comprehensive group of production-related indicators.

"During 1999 to 2001," Mr Ingham said, "oil prices were above $20 per barrel for 23 consecutive months. In the present cycle prices have been $20 or higher for 22 months through December and counting."

"In fact," Mr Ingham noted, "they have been above $25 for every month but one during 2003.

"Gas prices have become of greater import in recent years," he said. "We have now seen $4 plus gas for 14 consecutive months and counting."

The 2003 annual average gas price was $5.12 compared with $3.14 during 2002.

"The fact of the matter is that it takes prices at least above $20 and at least above $3.50 and probably more in the $4 range to generate the kind of activity we need, particularly in the natural gas market," Mr Ingham said, "to keep the industry propped up in Texas and to begin putting more employees on the payroll."

Mr Ingham believes the equilibrium price for oil is $25 per barrel presently and $4 for natural gas.

"What we are after," Mr Ingham explains, "is a price that in theory is high enough for the producers to survive and thrive and make the maximum contribution to the market place and not so high that the consumers begin to feel pinched."

Mr Ingham said it would not necessarily be a bad thing if the Petroindex began stabilizing at a level around the mid-130s. "That would actually represent the stability factor that I think would be very beneficial for both producers and consumers," he said.

"It's much easier to plan when you are operating on a stable plane rather than one that goes wildly up and down as cycles in Texas have continued to do.

Mr Ingham said the transformation in Texas from oil to natural gas is perhaps the key to achieving this stability. "If it is true that natural gas demand is such that the inability to meet this demand will keep prices relatively high," Mr Ingham explained, "that would suggest that activity in Texas is going to plateau but at a high level, and remain that way for some period of time."

"That would be good for producers and consumers."

RIG MARKET IMPLICATIONS

Mr Ingham believes it is not possible that activity levels are going to continue to increase, and that the Petroindex will not post another 18% increase in 2004. "I don't think we will be looking at another 30% increase in the rig count over the course of 2004 or a 20% increase in drilling permits, etc.," he said.

In fact, he said, the number of working rigs in Texas and the number of drilling permits issued have reached a plateau in recent months and are likely to stay at that level.

However, the Texas rig count in December 2003 stood at 477 according to Baker Hughes, compared with 369 in December 2003. That represents the highest year-end rig count since the index was begun. The annual average Texas rig count for 2003 was 449 compared with 338 in 2002, a nearly 33% increase. The annual average rig count in 2001 was 462.

Drilling permits totaled 12,664 in 2003 compared with 9,716 in 2002, a 30.3% increase. Comparing year to year, there were 1,152 drilling permits issued in December 2003 against 793 in December 2002, more than a 45% increase.

EMPLOYMENT OUTLOOK

Mr Ingham, citing government figures, noted that despite the increased activity during 2003 compared with 2002 that the industry should be employing more people than a year ago. However, that is not the case as employment is down slightly during 2003 from 2002. Employment in the oil and gas extraction segment in Texas is down 0.6% while oil and gas support employment is down 2.3% year over year.

"What is behind that is a little difficult to say," Mr Ingham said. "You would think that given the levels of activity as they increased in 2003 over 2002 that we would presently be employing more people in the industry than we did a year ago but that is not really the case."

"Is the fact that we have fewer rigs operating now responsible for the fact that we now have fewer employees in the industry, that we simply need less," Mr Ingham asked. "Or is it the fact that we don't have enough qualified trained employees that is holding back the rig count and other activity levels?"

"I think the latter has quite a lot of merit to it," Mr Ingham concluded.

"We have had some success in the past of attracting (people) back to the oil patch," he said. "We have not had that much success this time around."

Mr Ingham again noted that 2003 was a very solid year for oil and gas production in Texas. Texas oil production was worth nearly $10 billion, nearly a 19% increase in value over 2002. More than $28 billion worth of Texas natural gas was produced in 2003, outpacing the 2002 production value by nearly 59%.

However, Mr Ingham predicts that the volume of oil produced in Texas will continue to decline by 2-3% each year but activity in terms of natural gas is going to replace that decrease. "There are still a lot of people employed by oil production in Texas," he noted, "and that is not going to change any time soon."

"While we are moving for a decline in oil production and trying to hold steady in natural gas, this is going to be a state that produces a lot of oil and gas for decades to come." ■