News Release
THE FEDERAL RESERVE BANK of KANSAS CITY
DENVER • OKLAHOMA CITY • OMAHA
One Memorial Drive • Kansas City, MO 64198 • Phone: 816.881.2683

FOR IMMEDIATE RELEASE
Friday, July 8, 2016
CONTACT: Pam Campbell
405-270-8617
Pam.Campbell@kc.frb.org

TENTH DISTRICT ENERGY ACTIVITY WAS FLAT, OUTLOOK IMPROVED

Federal Reserve Bank of Kansas City Releases 2nd Quarter Energy Survey

KANSAS CITY, Mo. –The Federal Reserve Bank of Kansas City released the 2nd quarter Energy Survey today. According to Chad Wilkerson, vice president, economist, and Oklahoma City Branch executive at the Federal Reserve Bank of Kansas City, the survey revealed some improvement in Tenth District energy firm activity.

"Energy activity improved considerably this quarter and expectations were positive, largely due to the recent price gains," said Wilkerson. "Still, firms indicated prices need to be approximately $64 per barrel to see any substantial increase in drilling activity."

The Kansas City Fed's quarterly Tenth District Energy Survey provides information on current and expected activity among energy firms in the Tenth District. The survey monitors oil and gas-related firms located and/or headquartered in the Tenth District, with results based on total firm activity. Survey results reveal changes in several indicators of energy activity, including drilling, capital spending, and employment. Firms also indicate projections for oil and gas prices. All results are diffusion indexes – the percentage of firms indicating increases minus the percentage of firms indicating decreases. A summary of the 2nd quarter survey is attached. Results from past surveys and release dates for future surveys can be found at https://www.kansascityfed.org/research/indicatorsdata/energy.

Historical diffusion indexes on Table 2 may differ from previous releases due to a change in methodology.

###

Tenth District Energy Survey

Tenth District Energy Activity was Flat in the Second Quarter

Second quarter energy survey results suggested that Tenth District energy firm activity improved considerably. The future activity outlook turned positive for the first time in a year. On average, firms predicted WTI prices to be $53 per barrel by year-end 2016 and $62 by year-end 2017. Firms reported that prices on average needed to be $64 per barrel to increase drilling substantially. Additionally, firms did not expect to change hiring plans due to the recent recovery in oil prices.

Summary of Quarterly Indicators

District energy activity was flat in the second quarter of 2016, as reported by firms contacted between June 15 and 30 (Table 1). The drilling and business activity index increased from -72 to 0 (Chart 1), suggesting that activity was no longer significantly declining. The total revenues index increased moderately but remained negative at -31. The employment index rose modestly while the employee hours index stayed mostly flat. The wages and benefits index also edged higher. Access to credit continued to improve.

Year-over-year activity improved modestly but remained negative. The drilling and business activity index rose to -65, and revenues and profits also edged higher. The employment and employee hours indexes moved modestly higher, and wages and benefits also rose slightly. Access to credit inched higher for a second quarter. However, the capital expenditures index fell back to the low reached in the third quarter of 2015.

Expectations were significantly more optimistic this quarter. The future drilling and business activity index jumped from -31 to 39, the first positive reading in a year. The future revenues index also turned positive. Expectations for future employees and hours picked up moderately, and wages and benefits also increased but remained negative. The future access to credit index rose from -35 to 0. The future capital spending index climbed to 17, the first positive reading since 2014.

Price expectations for oil and gas strengthened further. The expected oil prices index inched higher to 58, meaning more firms expected prices to be higher in the future. The expected natural gas and NGL price indexes both also increased at a strong pace.

Summary of Special Questions

Firms were asked what they expected the WTI price to be by year-end 2016 and 2017. For year-end 2016, the average expected WTI price was $53, up from the $45 average last quarter and the $50 average in the fourth quarter of 2015 (Chart 2). Firms projected an average price of $62 by year-end 2017, up from the previous two quarter's $56 and $60 average.

Firms were asked what oil and natural gas prices were needed for a substantial increase in drilling to occur. This quarter's average oil price needed was $64 per barrel, up from the $60 average in the fourth quarter of 2015. The average natural gas price needed was $3.65 per million BTU.

Firms were asked about their view on the recent recovery in oil prices. Several firms pointed to the unexpected global production outages in Canada, Nigeria, and Libya and improved global demand data as factors. Others noted that U.S. shale production was falling faster than expected.

Firms were also asked if hiring plans had changed due to the recent recovery in oil prices. The majority of respondents did not plan to make any changes to their employment levels (Chart 3). Some respondents noted that they were filling a couple of important vacancies from a large pool of top talent.

Firms were also asked how they expected the recent rally in oil prices to impact their financing. The majority expected no changes or a decrease in credit. Several respondents commented that prices needed to be higher for a sustained period of time to see changes in credit availability. Banks and financial markets were expected to remain cautious.

Lastly, firms were asked how they expected mergers and acquisitions (M&A) and defaults and bankruptcies to evolve in the second half of 2016. A third expected large increases in M&A but little change in defaults/bankruptcies, while another third expected little change in M&A but large increases in defaults/bankruptcies (Chart 4). Some firms said that prices have been low for too long and therefore highly leveraged companies would continue to default in the coming months. Others said the recent price recovery would lead to some asset buying and acquisitions from better positioned companies.

Selected Comments

“The market is priced correctly with some limited increase in prices over the next couple years. Ultimately, there is plenty of supply and the real question is foreign economic growth and the demand for oil. The demand issue is a much longer, harder issue to solve in the oil market.”

“The temporary uptick in prices was due to upside surprise on demand (especially India) and temporary outages in Canada and Venezuela. Longer term, excess capacity is being eliminated and it appears the markets may be in balance by year end.”

“Commodity price continues to drive business activity. We plan to keep cash flow neutral and mend balance sheet as price recovery occurs with cautious approach to acceleration of activity.”

“Oil prices are not high enough to either justify drilling or to justify lenders to increase the base price on which they lend on oil.”

“The industry needs to see substantial price increases to get lenders to feel comfortable with the industry and its ability to make profits.”

“Many producers are so upside down they can’t sell even though there is a lot of money available. This will lead to more bankruptcies and restructurings. After that we will see mergers and acquisitions pick up.”

“With reaching a bottom in prices, some company consolidations will increase. Still too big of a spread between bid and ask price. Refinancing should be a bit easier with improved price expectations but prices need to maintain upward strength.”

“The financial market will continue to take a very conservative view on commodity pricing. Many analysts predict that the industry will overreact and create another surplus before long term supply and demand come into balance.”

“Service company prices have been reduced so far that the cost of developing a well is now profitable at the lower prices.”

Table 1
Summary of Tenth District Energy Conditions, Quarter 2, 2016

	Quarter 2 vs. Quarter 1 (percent)*				Quarter 2 vs. Year Ago (percent)*				Expected in Six Months (percent)*			
Energy Company Indicators	Increase	No Change	Decrease	Diff Index^	Increase	No Change	Decrease	Diff Index^	Increase	No Change	Decrease	Diff Index^
Drilling/Business Activity	28	44	28	0	10	16	74	-65	61	16	23	39
Total Revenues	25	19	56	-31	9	13	78	-69	58	10	32	26
Capital Expenditures					6	3	90	-84	45	28	28	17
Supplier Delivery Time	3	90	7	-3	3	79	17	-14	7	83	10	-3
Total Profits	31	16	53	-22	10	10	81	-71	52	19	29	23
Number of Employees	0	41	59	-59	0	33	67	-67	25	56	19	6
Employee Hours	0	48	52	-52	3	45	52	-48	23	61	16	6
Wages and Benefits	6	50	44	-37	10	39	52	-42	16	66	19	-3
Access to Credit	13	57	30	-17	7	40	53	-47	19	61	19	0
Expected Oil Prices									64	30	6	58
Expected Natural Gas Prices									64	33	3	61
Expected Natural Gas Liquids Prices									63	34	3	59

*Percentage may not add to 100 due to rounding
^Diffusion Index. The diffusion index is calculated as the percentage of total respondents reporting increases minus the percentage reporting declines.

Note: The second quarter survey ran from June 15-30, 2016 and included 33 responses from firms in Colorado, Kansas, Nebraska, Oklahoma, Wyoming, northern New Mexico, and western Missouri.

Chart 1. Drilling/Business Activity Index vs. a Quarter Ago

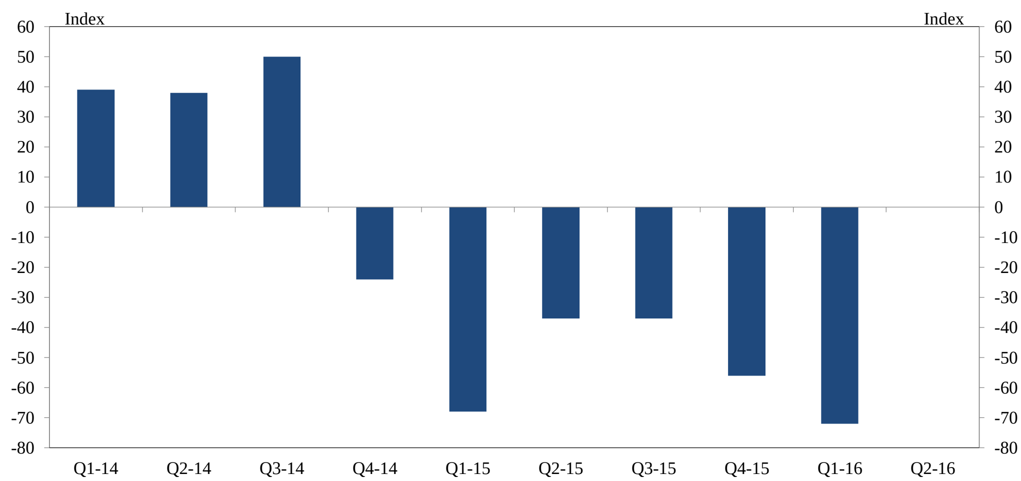

Table 2
Historical Energy Survey Indexes

	Q1'14	Q2'14	Q3'14	Q4'14	Q1'15	Q2'15	Q3'15	Q4'15	Q1'16	Q2'16
Versus a Quarter Ago										
(not seasonally adjusted)										
Drilling/Business Activity	39	38	50	-24	-68	-37	-37	-56	-72	0
Total Revenues	33	57	72	-42	-81	-45	-58	-86	-67	-31
Supplier Delivery Time	-3	12	-15	4	-3	11	6	-6	-9	-3
Total Profits	31	34	50	-44	-86	-53	-61	-76	-78	-22
Number of Employees	42	28	41	0	-26	-37	-41	-49	-69	-59
Employee Hours	20	14	34	-19	-43	-19	-39	-39	-54	-52
Wages and Benefits	48	34	45	12	0	-16	-30	-33	-50	-37
Access to Credit	6	15	14	-12	-17	-10	-41	-49	-39	-17
Versus a Year Ago										
Drilling/Business Activity	26	19	56	-23	-63	-84	-91	-89	-84	-65
Total Revenues	53	63	71	-4	-70	-77	-88	-92	-81	-69
Capital Expenditures	19	30	52	-11	-67	-62	-84	-76	-73	-84
Supplier Delivery Time	-3	12	-15	8	11	-4	-18	-3	-6	-14
Total Profits	38	46	62	-16	-74	-90	-89	-92	-81	-71
Number of Employees	35	28	67	35	-13	-32	-47	-56	-78	-67
Employee Hours	20	11	33	4	-43	-38	-54	-40	-66	-48
Wages and Benefits	59	38	67	38	3	-28	-25	-26	-47	-42
Access to Credit	3	11	26	-25	-43	-32	-40	-56	-53	-47
Expected in Six Months										
(not seasonally adjusted)										
Drilling/Business Activity	34	58	46	-83	-53	20	-26	-43	-31	39
Total Revenues	59	74	69	-60	-42	19	-36	-56	-17	26
Capital Expenditures	20	33	44	-64	-67	-3	-41	-67	-50	17
Supplier Delivery Time	-3	4	-11	15	10	-10	-3	-9	-3	-3
Total Profits	47	59	61	-76	-52	-3	-38	-63	-22	23
Number of Employees	42	50	59	-23	-29	-7	-34	-51	-39	6
Employee Hours	29	26	39	-48	-26	0	-24	-42	-39	6
Wages and Benefits	34	32	69	-8	-26	7	-14	-27	-38	-3
Access to Credit	13	29	23	-40	-21	0	-31	-40	-35	0
Expected Oil Prices	3	24	-23	-52	3	32	20	-9	41	58
Expected Natural Gas Prices	22	30	37	-26	-19	16	11	-15	18	61
Expected Natural Gas Liquids Prices	26	26	-4	-42	-13	10	6	-15	29	59

Chart 2. Special Question - What price of oil is needed for a substantial increase in drilling to occur, and what do you expect the WTI price to be at the end of 2016 and 2017?

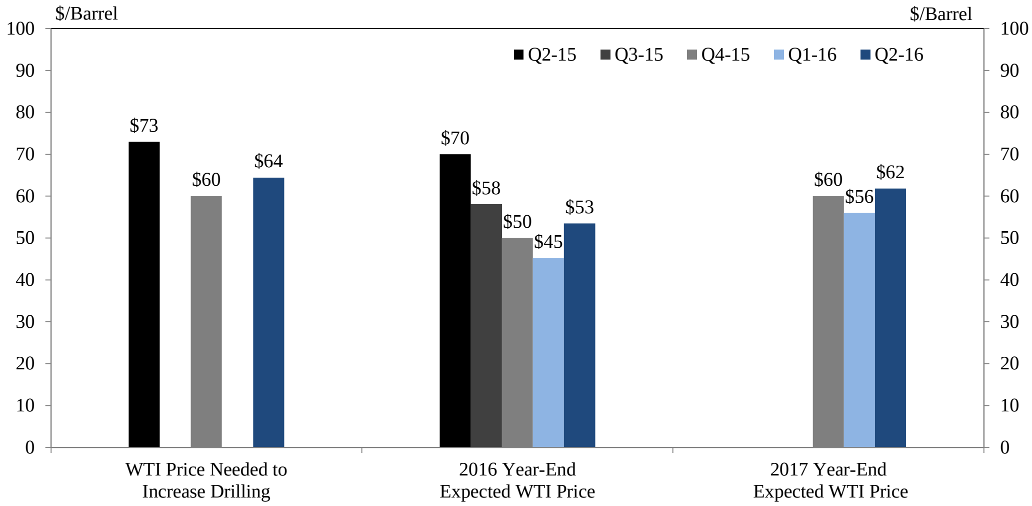

Chart 3. Special Question - Have you changed your hiring plans due to the recent recovery in oil prices?

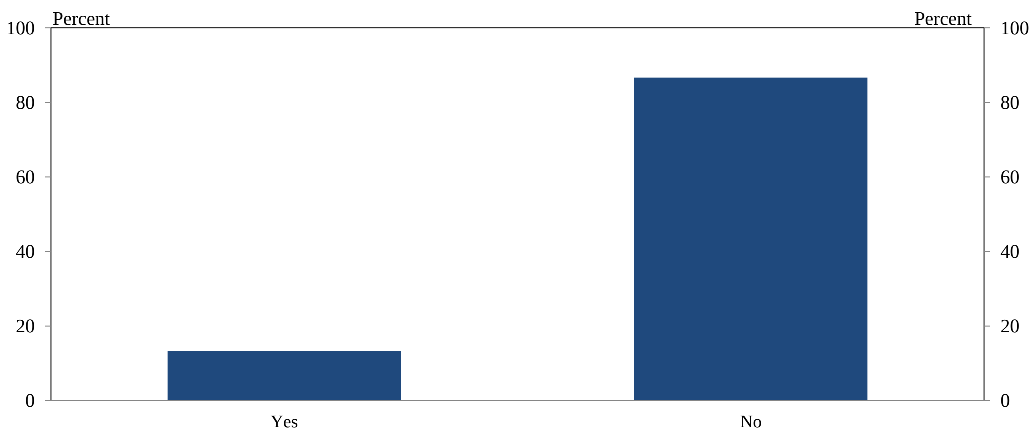

Chart 4. Special Question - How do you expect mergers and acquisitions (M&A) and defaults/bankruptcies in the energy sector to evolve in 2016 (Q4-15) and in the second half of 2016 (Q2-16)?