



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

An American resurgence

What's old is new again - and in a place that until recently would have been considered unlikely: American manufacturing.

At the fore of this industrial renaissance is Oklahoma, whose economic growth continues to be led by manufacturing and energy. The two industries created nearly 14,000 new jobs over the past year, with the bulk of manufacturing growth in oil and gas machinery and equipment.

The technological breakthroughs in shale gas exploration have cemented

Oklahoma's status as an energy leader, but its manufacturing strength goes beyond the energy industry. With its low cost of business and diverse manufacturing history, which included salt production in the 1800's, glass and automobiles in the early 1900's and more recently, aeronautics and energy equipment, the state is well-positioned to capitalize on predictions for a resurgence of American manufacturing.

In a recent series of reports on manufacturing, the Boston Consulting Group (BCG) identified industries currently imported by the U.S. from

China for which it predicts rising foreign labor costs will likely return the manufacturing of those goods to the U.S. within the next five years. BCG estimated that if just 10 to 30 percent of the China-produced imports shift back to U.S. manufacturers, the nation's domestic output could increase by \$20 billion to \$55 billion annually.

Factors contributing to the shift away from offshore labor include technological advances, such as robotics, that are primed to reduce labor-intensive

SEE RESURGENCE PAGE 4

Inside

- Commentary by Commerce Secretary Dave Lopez
- Editor's note: A disclaimer
- Tribal gaming fee growth slowing
- Growth in income, sales push July collections positive
- State unemployment rises
- Economic briefs
- Economic indicators

Staff

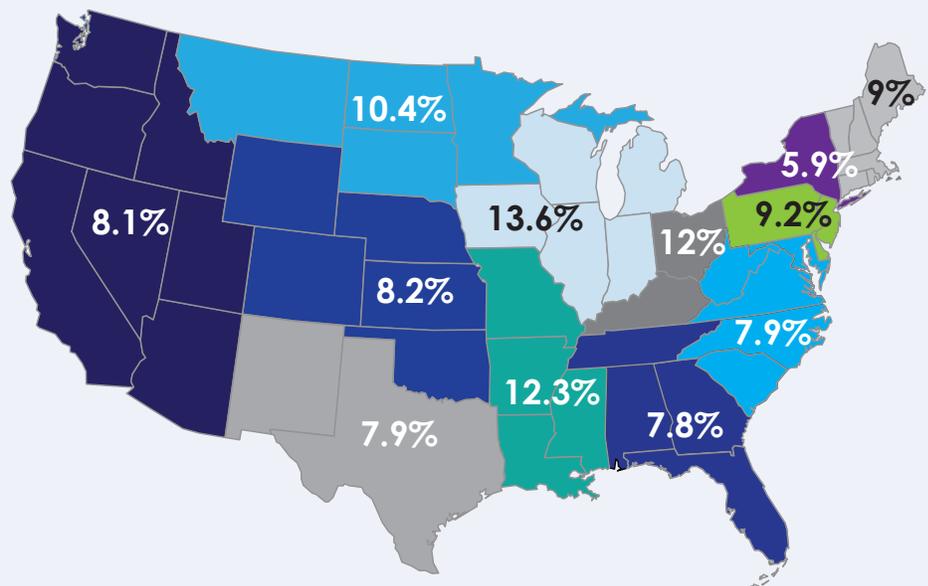
Regina Birchum, Deputy Treasurer for Policy

Editor

Tim Allen, Deputy Treasurer for Communications

Manufacturing Sector Share of Employment

(by Federal Reserve District, Second Quarter 2011)



Sources: U.S. Bureau of Labor Statistics



Secretary's Commentary By Commerce Secretary Dave Lopez



A confident foundation

Confidence.

Samuel Johnson, the 18th century writer, described confidence as “the first requisite for great undertakings.”

More recently, Tina Fey said: “Confidence is 10% hard work and 90% delusion.”

Whether one describes confidence with wisdom or wit, confidence is a foundational factor for successful business enterprise. Thankfully, confidence is abundant in Oklahoma.

Earlier this year, Governor Mary Fallin’s survey of Oklahoma businesses indicated much greater optimism by Sooner State businesses than national results. That confidence can be witnessed by an impressive run by Oklahoma’s economy.

Here are just a few metrics:

- Oklahoma is first in the nation in manufacturing job growth during the past 12 months...and we’ve held that position for nearly the entire calendar year thus far.

- The state is third in the overall rate of job growth during the past 12 months.
- No state in the nation with more than 2 million residents has a lower unemployment rate than Oklahoma.

The numbers also indicate Oklahoma is more prosperous. Grubb & Ellis reported during eight of the past

nine quarters only three states have experienced personal income growth that exceeded that of the nation: Texas, North Dakota and Oklahoma.

Those of us currently in public

service do understand that we are not the ones creating the jobs, increasing wealth and powering one of America’s strongest state economies. But I do believe government is helping create a climate in which business can flourish.

Merriam-Webster’s defines confidence as “the quality or state of being certain.” Well, Oklahoma employers have been able to be more certain than most that their state government is business friendly.

Here are just three key ways

“... government is helping create a climate in which business can flourish.”

policy makers have helped create an improving ecosystem in which capitalism can thrive.

1. Oklahoma has shown strong fiscal management. Recall early 2011 we faced a \$500 million deficit and the rainy day fund had a balance of \$2.03? Today, state revenues exceed estimates and the rainy day balance is \$577.5 million.
2. The Legislature and Governor Fallin joined to implement measures in areas vital to business, including transportation infrastructure, tort reform, workers compensation and education reform.
3. Incentives that demonstrate they aid economic growth—such as the Quality Jobs program and the aerospace engineer tax credit—have been preserved.

It’s my belief the good news for Oklahoma will continue because of alignment between public and

SEE LOPEZ PAGE 3



Lopez

FROM PAGE 2

private sectors. Already this year, we've had positive news on job expansions including Asco, Boeing, Baker Hughes, Halliburton, Schlumberger, Google

and dozens more. Overall, Oklahoma has added nearly 50,000 jobs since Governor Fallin took office.

It's easy with this momentum to be confident. But, that's not to say we're on a path without any speed bumps.

We do have challenges. For example, we need to enhance workforce capacity, improve our physical health and attract

more workers with academic credentials in STEM fields. We also are vulnerable to national issues or global economic factors.

Still, we have reason to be confident. With apologies to Tina Fey, Oklahoma's confidence is not at all a delusion. Rather, as Samuel Johnson alluded, we can launch from confidence to even greater undertakings.

Editor's note: A disclaimer

As readership of the *Oklahoma Economic Report* continues to grow, beginning with this month's edition a disclaimer will be included as clarification for those who might cite or otherwise reference material published on these pages.

This publication strives for a balanced presentation of viewpoints, and as such, will sometimes contain articles stating opposing sides of a policy debate.

Clearly, one cannot endorse both sides of an issue. Unfortunately, we recently had to obtain a retraction in a business publication after a columnist credited the treasurer with someone else's position simply because their work was referenced in this publication.

This new disclaimer will serve as a reminder that the *Oklahoma Economic Report* seeks to inform readers with well-balanced news and policy perspectives and reserves opinion for the commentary section.

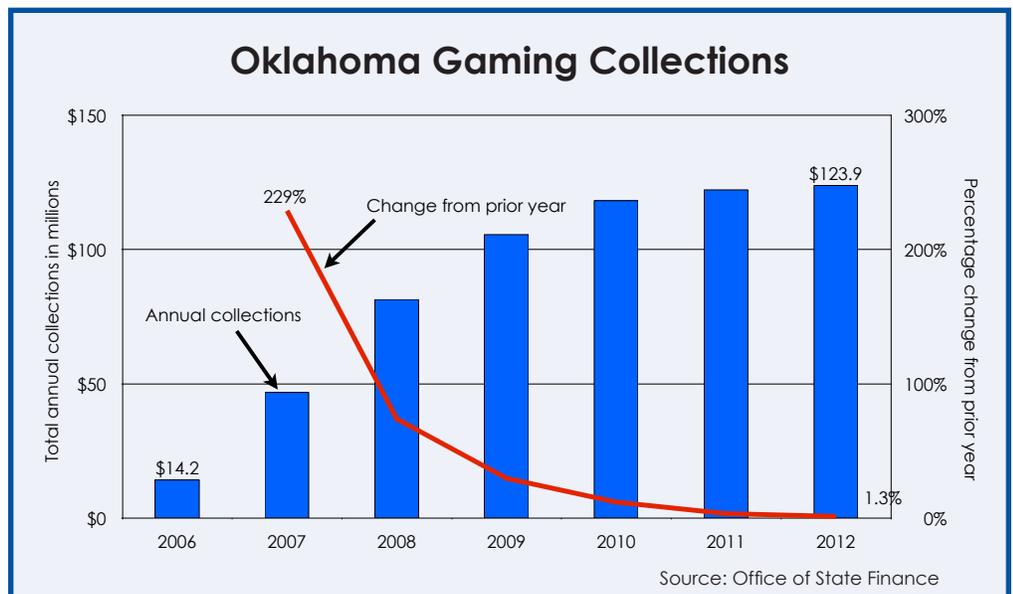
Tribal gaming fee growth slowing

After experiencing several years of extensive growth, state collection of fees on tribal gaming are showing signs of leveling off.

While fees paid to the state by tribal nations for use of electronic and card games covered by compacts has grown from \$14.2 million in Fiscal Year 2006 to \$123.9 million in Fiscal Year 2012, officials believe collections could be at or near their peak.

As collections grew, so did the number of tribal casinos in the state, with approximately 100 today. However, not all casinos use compacted machines and the market could be reaching a saturation point.

Collection of the gaming fee was approved by voters in 2008. Proceeds are divided with 88 percent going to common schools and 12 percent to the General Revenue Fund.



Opinions and positions cited in the *Oklahoma Economic Report*™ are not necessarily those of Oklahoma State Treasurer Ken Miller or his staff, with the exception of the *Treasurer's Commentary*, which of course, is the viewpoint of the treasurer.



Resurgence

FROM PAGE 1

manufacturing processes that even low-cost labor nations will find hard to compete with.

But cheap labor is not what it used to be. China once boasted wages at just three percent of what average U.S. factory workers earned. Between 2005 and 2010, China's wages rose by an average of 19 percent each year compared to American production labor cost increases of less than four percent annually over the same time frame.

BCG analysts forecast that by 2015, China's cost advantage in manufacturing goods will be reduced to just 10 to 15 percent over American-made products, likely negating any economic advantage after shipping and other global costs are factored in.

Aiding this shift are innovative

processes that allow easier customization of some products, potentially reducing the need for large and expensive manufacturing plants, which could lead to more local manufacturing. Concerns over protecting intellectual property are also factoring into location decisions.

The trove of America's natural gas supplies unlocked through new drilling techniques has also spurred manufacturing growth. The abundance of affordable natural gas has led major chemical companies to reassess future operations. Dow Chemical recently announced \$4 billion in new manufacturing projects, including a new

plant in Texas to convert natural gas into materials to be used in the production of plastics. Three other major chemical companies have announced plans for new facilities in close proximity to major shale-gas sources. Industry experts such as Pricewaterhouse-Coopers LLP have projected that by 2025, as many as 1 million manufacturing jobs directly attributable to shale gas could be created.

The resurgence of energy and manufacturing sectors is more than just welcome news for workers and local economies; it puts America on a path to attaining economic and energy security.

Energy consultants PFC Energy projects that America will become the world's top producer of oil, gas and biofuels by 2020, ending the country's reliance on the Middle East. That forecast doesn't seem far-fetched considering that this past December marked the first time since 1961 that the U.S. exported more gasoline than it imported, and that in 2011 it became the clear leader in global gas production, surpassing Russia, the top gas producer for the past decade.

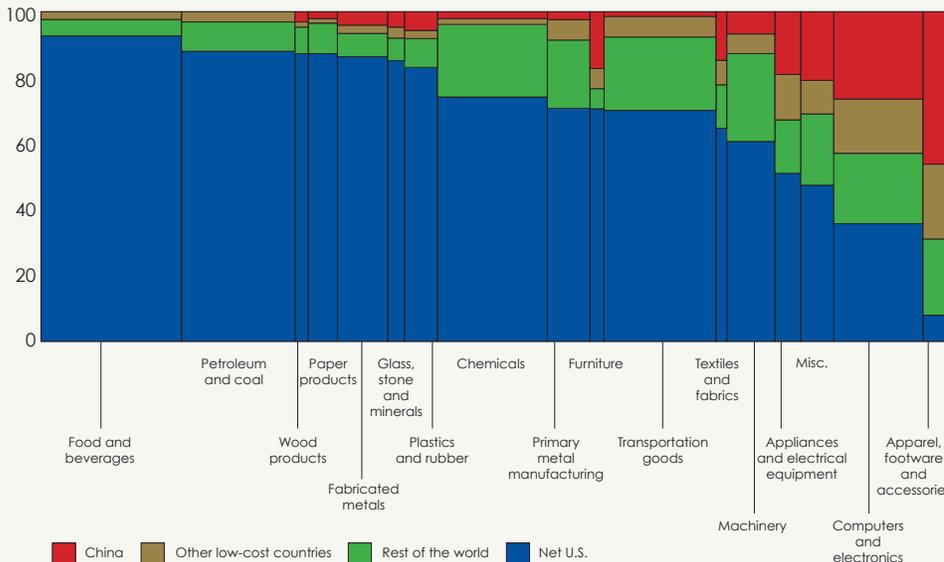
With the nation manufacturing nearly 75 percent of what it consumes, increased energy and manufacturing production could well make the U.S. not just self-reliant but also a major exporter of products it once imported.

While a return of the U.S. as a

“The resurgence of energy & manufacturing puts America on a path to economic and energy security.”

The U.S. Manufactures Almost 75% of What It Consumes

Manufactured goods consumed in the U.S. by source, 2010 (%)



Sources: Census Bureau, Bureau of Economic Analysis, BCG analysis

SEE RESURGENCE PAGE 5



Resurgence

FROM PAGE 4

manufacturing powerhouse seems likely, there is one looming concern: whether there will be a skilled workforce ready to meet the demand.

The Manufacturing Institute's Skills Gap Report found two-thirds of manufacturers are having difficulty

finding qualified workers, and more than half of those respondents anticipate the shortage to worsen within the next five years.

Those surveyed reported a median of five percent of available jobs remained unfilled because of a lack of candidates with the right skills.

As manufacturers relocate or expand in the states, Oklahoma has advantages in its low business costs and an active energy industry.

The challenge now is to ensure it has the workforce that a manufacturing boom will certainly demand.

Manufacturing Growth in Oklahoma in 2012

Company name	Location	New or expanding	Job Estimates
A G Equipment Company	Broken Arrow	Expanding	268
AFG Acquisition Group, LLC	Bixby	Expanding	250
Ameron International Corporation	Tulsa	Expanding	129
Avery Barron Industries – Stamping, LLC	Tulsa	Expanding	77
Cameron International Corporation	Moore	Expanding	263
Compass Manufacturing, LLC	Oklahoma City	Expanding	81
CSI Aerospace Inc.	Broken Arrow	Expanding	75
Cyclonic Valve Company	Broken Arrow	Expanding	45
D & L Manufacturing, Inc.	Tulsa	Expanding	100
Exopack, LLC	Catoosa	Expanding	44
Fintube, LLC	Tulsa	Expanding	91
Gefco, Inc.	Enid	Expanding	233
Gonzales Machine, Inc.	Davis	Expanding	60
HyPro, Inc.	Vinita	Expanding	200
J.A. Oil Field Manufacturing, Inc.	Oklahoma City	Expanding	70
Limco Airepair, Inc.	Tulsa	Expanding	182
Oklahoma Materials Recycling, LLC	Atoka	New	50
Team Oil Tools, LP	Tulsa	Expanding	200
The Boeing Company	Oklahoma City	Expanding	255
Total Energy	Stillwater	New	200+
Trinity Tank Car, Inc.	Oklahoma City	Expanding	280
Tulsa Winch, Inc.	Jenks	Expanding	100
Webco Industries, Inc.	Sand Springs	Expanding	106
Wilco Machine & Fab, Inc.	Marlow	Expanding	100
Wood Flowline Products, LLC	Davis	Expanding	152

Source: Oklahoma Department of Commerce

Economic briefs

A recent paper by Fed economists finds two reasons why this cyclical recovery has been so weak. One is that it has followed a recession in which housing had a severe downturn. The other is that when recessions are longer than average, the subsequent recoveries have been slow.

...

Using a combination of debt plus unfunded pension liabilities as a percent of GDP, the strongest states are South Dakota, Iowa and Tennessee. The weakest are Connecticut, Illinois, Hawaii and Kentucky. Illinois pays higher borrowing costs, Connecticut does not.

...

Hedge funds account for nearly a quarter of all bond trading, or 30% more than a year ago. Much of that trading is in Treasuries due to the high liquidity in that market. Whenever there is a surprise from the economic indicators or the Fed there tends to be a spike in hedge fund trading of Treasuries.

...

Reprinted with permission from Baird Fixed Income Commentary, August 27, 2012



Comparing July gross receipts and the General Revenue Fund

Comparison of the Treasurer's August 2 Gross Revenue report and State Finance's August 14 General Revenue Fund (GRF) report illustrates key differences.

July gross receipts totaled \$854.97 million, while the GRF received \$389.1 million or 45.5% of the total.

In June, the GRF received 56.4% of the gross. Monthly variances of 35% to 58% show the value of using total collections to gauge state economic performance.

From July gross receipts, the GRF received:

- Personal income tax: 67%
- Corporate income tax: 28.3%
- Sales tax: 46.4%
- Gross production-Gas: None
- Gross production-Oil: None
- Motor vehicle tax: 29.6%
- Other sources: 34%

July GRF allocations exceeded the official estimate by \$20 million or 5.4 percent. In June, collections fell short of the estimate by \$39.9 million or 6.6 percent.

For the month, insurance premium taxes totaled \$1.4 million.

Tribal gaming fees generated \$13.2 million during July.

Growth in income, sales push July collections positive

Driven by increases in income and sales, Oklahoma's total revenue collections resumed their rise in July after dipping slightly the month before, State

Treasurer Ken Miller said as he released the gross receipts to the treasury report for the first month of the fiscal year.

Total treasury collections in July grew by just more than one percent

over the same month of last year, aided by a double-digit jump in income tax collections but hampered by a more than 43 percent plunge in collections on oil and gas production. It marks the eighth

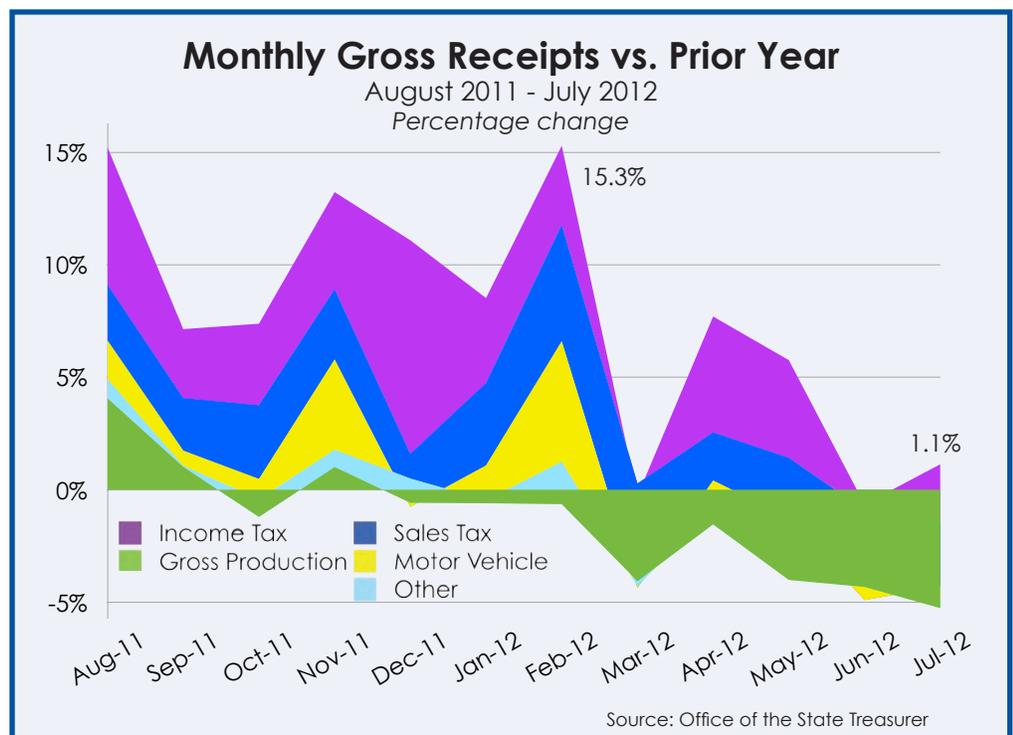
consecutive monthly decline in gross production tax collections from the same month of the prior year.

"While the overall rate of growth in collections has slowed somewhat in the past few months due to lower energy prices and production, most other economic indicators remain positive," Miller said. "Our July report

shows sustained consumer confidence in the economy with Oklahomans earning and spending more money."

SEE REVENUE PAGE 7

“Our July report shows sustained consumer confidence in the economy . . .”





Revenue

FROM PAGE 6

July treasury collections are up by 1.1 percent from July of last year, Miller said. That compares to average growth in the past 12 months of 7.2 percent, including an almost 11 percent increase in income tax collections and almost 9 percent growth in sales tax collections.

Dodging a bullet

Reports from the Oklahoma Tax Commission show low natural gas prices earlier this year will not result in a three percentage point gross production tax rate decrease. If reports had shown the average price paid for Oklahoma-produced natural gas was below \$2.10 per thousand cubic feet (mcf) in March or April, the lower rate would have been triggered for collections remitted in July and August.

While the spot price of gas at the Henry Hub in Louisiana was \$2.06/

mcf in March and \$2.01/mcf in April, Oklahoma-produced gas sold for \$2.92/mcf in March and \$2.17/mcf in April. The regular gross production tax rate is seven percent, but would have been cut to four percent had the price trigger been met.

Miller said concerns have eased somewhat in recent weeks as natural gas spot prices are generally above \$2.90/mcf. Crude oil prices, which dropped over the past few months, are now more than \$90 per barrel.

When natural gas prices dropped, many producers switched to oil drilling and that trend continues. Baker Hughes reports show 37 active natural gas rigs in Oklahoma in early August, compared to 124 a year ago. Active oil rigs were reported as 156 for oil, compared to 53 at the same time last year.

Outside influences

As concerns with the energy sector

have lessened, Miller said concerns are growing that outside influences could negatively impact the state's economy in the coming months.

"The European debt crisis, China's economic slowdown and political and economic uncertainty in Washington could harm Oklahoma's well-performing economy," he said.

"The biggest domestic threat is the self-imposed 'fiscal cliff' compliments of Congress and the President," Miller said. "Without action in Washington to put the federal government on a sustainable fiscal course while recognizing the fragility of the recovery, the U.S. economy could join Europe in another recession."

State unemployment increases in July

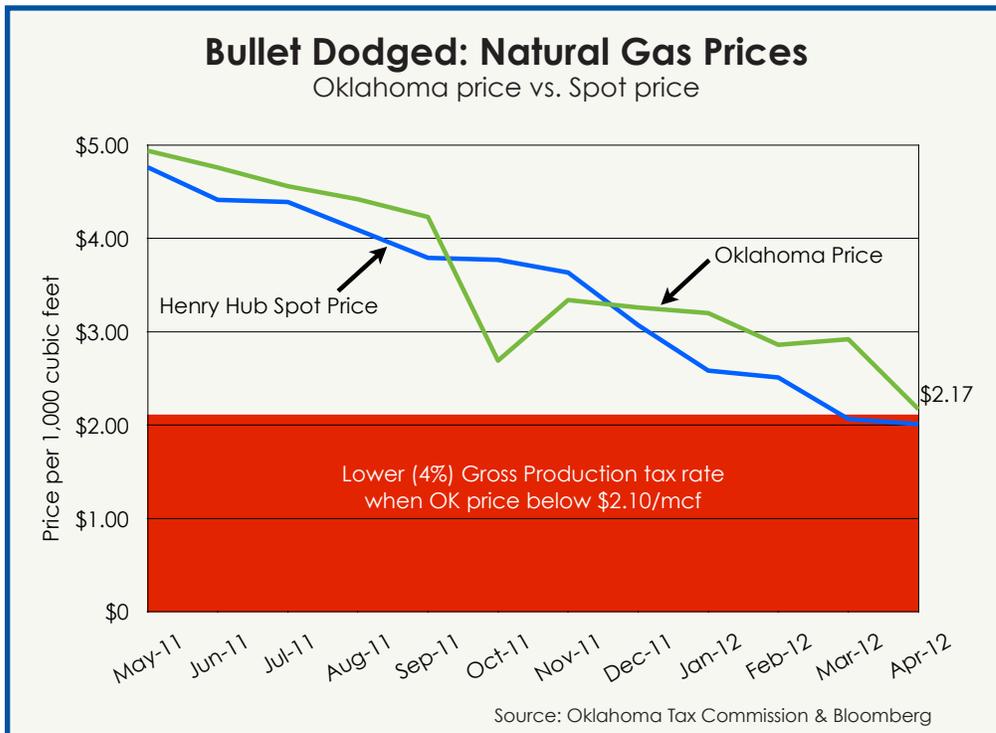
After dropping for six consecutive months, the Oklahoma unemployment rate ticked upwards by 0.2 percentage points in July to 4.9 percent, according to the Bureau of Labor Statistics.

July's rate compares to 4.7 percent in June and 6.2 percent in July 2011.

Compared to June, the state labor force increased by 880, with a net loss of 1,980 jobs and an increase of 2,860 unemployed persons.

Since July 2011, the labor force has grown by 29,050, with 50,870 added jobs and 21,820 fewer unemployed persons.

Oklahoma is one of four states to see unemployment rise during the month. Two states had no change and 44 saw declines. Nevada is the highest at 12 percent and North Dakota is lowest with 3.0 percent.

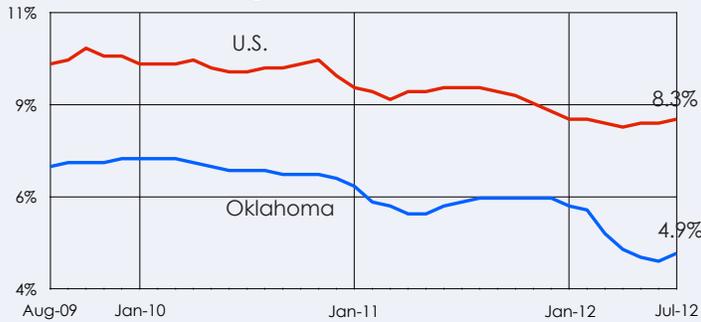




Economic Indicators

Unemployment Rate

August 2009 – July 2012



Source: Bureau of Labor Statistics

Oklahoma Stock Index

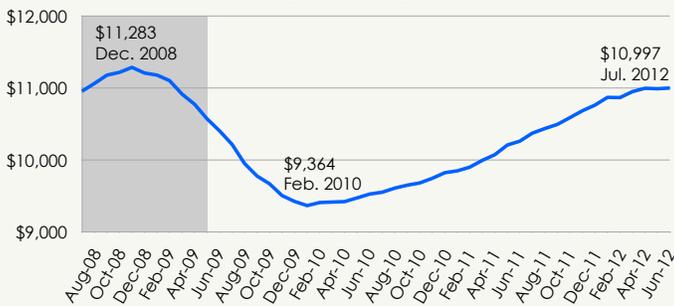
(Top 25 capitalized companies)



Source: Office of the State Treasurer

Oklahoma 12-Month Gross Receipts

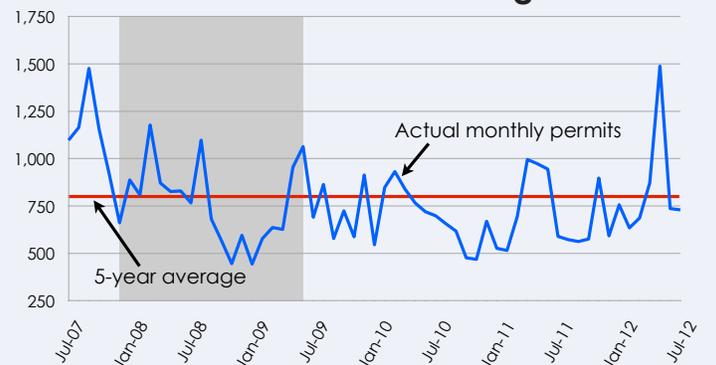
August 2008 - July 2012
(in millions)



Shaded area denotes U.S. recession

Source: Office of the State Treasurer

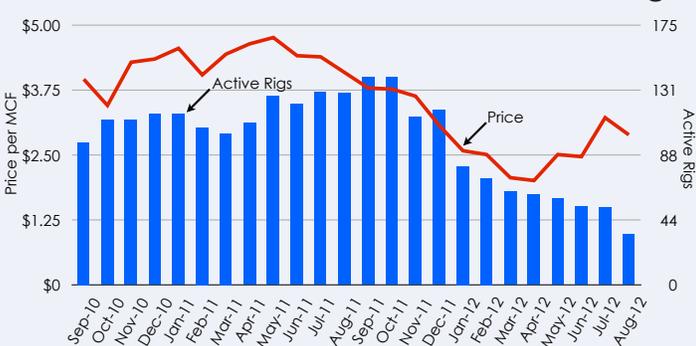
Oklahoma Residential Building Permits



Shaded area denotes U.S. recession

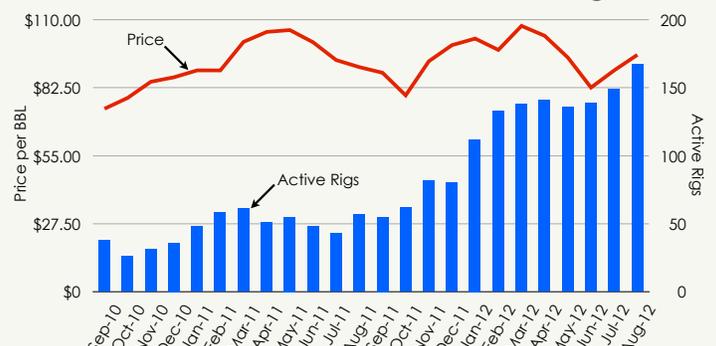
Source: U.S. Census Bureau

Oklahoma Natural Gas Prices & Active Rigs



Source: Baker Hughes & Bloomberg

Oklahoma Oil Prices & Active Rigs



Source: Baker Hughes & Bloomberg