

Too much supply, too little demand sickens oil prices — cure takes time

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Overproduction is oversupplying demand

- The equivalent of one out of every seven barrels of last week's U.S. oil production went into storage — no one needs the crude
- That's the equivalent of almost a month of North Slope production
- Permian Basin producers have asked Texas regulators to consider imposing production limits to reduce oversupply, boost prices
- Bankruptcies starting: Whiting Petroleum, once the Bakken's largest producer, saw its market cap fall from \$15 **billion** to \$61 **million**

Market was shaky before coronavirus

- China's economic growth rate last year was its lowest in years
- Europe wasn't looking strong; U.S. consumption flat in 2019
- Though producers were pumping more and betting on demand, their bet was looking increasingly likely to come up a loser
- Then, the virus hit and prices dropped more than 20% in January as global oil demand started to fall, with China leading the way
- Lockdowns spread and demand fell; prices down 65% since Jan. 1

U.S. guilty of overproducing too

- U.S. oil production record high 13 million barrels per day in January
- Doubled in just the past eight years
- Almost 9 million barrels a day from shale and other tight oil
- Permian Basin by itself is up to almost 5 million barrels a day
- Output far exceeds needs; exports went from 100,000 barrels a day in 2013 to more than 3.6 million barrels a day in December 2019
- It's a buyer's market; a seller's nightmare; and it was unsustainable

Russia wasn't about to lose out to U.S.

- Russia reached record oil production last year, averaging 11.25 millions per day, second only to the U.S.
- When Russia agreed last year to continue its 3-year-old OPEC+ production curbs, it wisely ensured that natural gas liquids (condensate) were excluded from its production numbers
- With its ever-expanding production from wet-gas fields, Russia reported 2019 condensate at 1 million barrels a day

And then schoolyard fight started

- In early March, seeing oil demand start to crash worldwide, Saudis wanted to extend and expand OPEC+ production deal
- Russia said it wasn't convinced of need for further production limit
- Besides, Rosneft CEO, a close ally of Putin, whispered in Putin's ear that it would be good time to smack down U.S. shale producers
- Russia said no to further production limits; Saudis overreacted and said no to extending existing limits; just as demand was falling

Who will blink first

- U.S. at record 13 million barrels a day, but over-leveraged shale producers can't raise more money and are starting to cut back
- Goldman Sachs says U.S. production could drop 10% by mid-2021
- Russia had been talking of boosting output to 12 million barrels
- Saudis in March pumped record volume, also targeting 12 million
- Meanwhile, Norway's newest offshore field is on target to reach 470,000 barrels a day in May, after just starting up in October

A little hope this week for the oil patch

- Putin said April 1 all producing and consuming nations need to work together to find a solution to help stabilize markets
- Russia, Saudis and other OPEC nations to meet Monday to discuss cuts totaling 6 million barrels a day; want signal of U.S. cuts too
- China has directed state entities to stock up on cheap crude for national reserves; directive covers commercial storage too
- Enough potential good news to help boost prices 30% past 2 days

Demand loss a big long-term problem

- Coronavirus lockdowns have cut deeply into oil demand
- While production exceeds 100 million barrels a day, the world is consuming around 80 million barrels — on a good day
- Goldman Sachs says demand is falling toward 75 million a day
- Commodities trader Trafigura says 70 million a day is possible
- Without large-scale, immediate production cutbacks worldwide, more than 1 billion barrels could go into storage in April alone

Storage is not unlimited

- There are limits to how much crude the world can store
- Storage is costly — no reason to hold it unless there's a profit
- Commercial storage at U.S. hub in Cushing, Oklahoma, more than doubled to 50 cents per barrel, per month — if it's available
- U.S. Strategic Petroleum Reserve (SPR) has room, but Congress has not appropriated any funding to add to crude stockpile
- Besides, most of the SPR is for sour crude, and shale is sweet crude

If not by land, maybe by sea

- Saudis have chartered extra crude carriers, overheating the market
- Tanker rates as high as \$200,000 a day this week, 5X a year ago
- Recent reports of a U.S. Gulf Coast-to-China charter at almost \$20 million, costing \$10 per barrel to delivery \$20 crude
- Floating storage only makes financial sense when futures prices are \$10 to \$15 per barrel above the cost of buying the crude
- It's gotten so bad that there's interest in storing crude in rail cars

The bad news continues to spread

- At least one major U.S. oil pipeline operator has notified shippers they need to show proof that they have buyers to take delivery
- Landlocked crude — especially the lower-quality heavy oil — is selling in the single digits in Canada, Wyoming and elsewhere
- As banks reprice oil reverses, they reduce credit lines and call loans
- Oil-field service companies are laying off workers, and even fracking sand mines are suffering from weakening demand

Warnings of the future if investment stops

- Short-term, a lack of investment is not an immediate problem
- But longer-term, assuming global demand recovers, a shortage of investment in new production could lead to price spikes
- Only the strongest companies will be able to think long term
- Expect consolidation in the industry, which is a polite way to say some companies will be bought up or simply go out of business

Alaska not immune to the illness

- ConocoPhillips has announced cutbacks in 2020 capital spending
- Oil Search will reduce spending at Pikka; could delay first output
- Hilcorp was looking to issue debt to fund purchase of BP assets
- And the state will lose out on hundreds of millions of dollars in production tax and royalty payments that had been expected at \$60 oil, stressing the budget and accelerating the need for new taxes and jeopardizing the 2021 dividend