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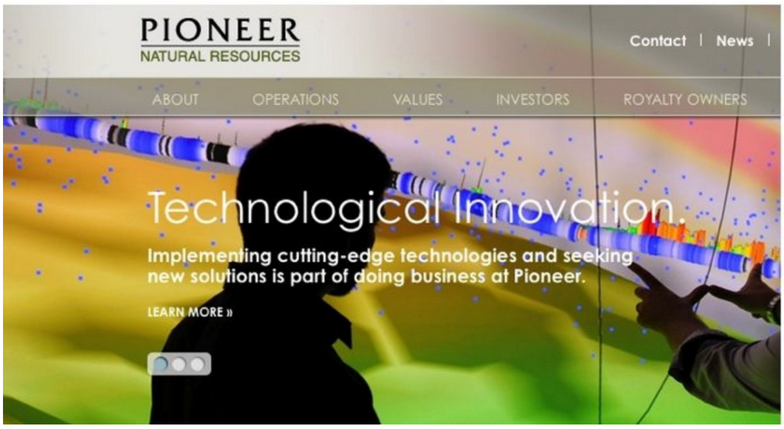
U.S. Oil Shale Producers Putting OPEC Into Financial Bind



This wasn't supposed to happen. When OPEC decided in November 2014 to keep producing crude oil at or near maximum rates, it was following an unspoken strategy to force the U.S. oil shale industry to back off. That would allow prices to rise back to levels needed to fund the cartel's military adventures and their welfare states.

Marginal producers in the United States did declare bankruptcy, while other producers stacked most of their oil rigs, cutting daily production in the country from 9.7 million barrels per day (mpd) to 8.5 mpd. This caused crude oil prices to rise from the low 30s to the mid 50s.

But then oil prices levelled off and began to decline, touching $40 a barrel earlier this week, with further declines expected. The reprieve that Saudi Arabia, the largest producer in the OPEC cartel, was hoping for hasn't materialized. It continues to liquidate its stash of foreign currency reserves by $11 billion a day, giving it an estimated 18 months before it will be forced to make major financial decisions about its future.

What happened could have been predicted: The American oil shale industry became more innovative and more efficient, bringing down their breakeven points to historically low levels. Scott Sheffield, the outgoing chief of Pioneer Natural Resources, an oil shale pioneer sitting on an estimated 75 billion barrels of recoverable oil, announced that his company's production costs in the Permian Basin of West Texas have fallen to just $2.25 a barrel. He declared, "Definitely we can compete with anything that Saudi Arabia has. We have the best rock."

Pioneer has cut its production costs by more than a quarter in just the last year alone, developing multi-pad drilling strategies which allow three or more wells to be drilled from the same surface installation. It is so optimistic about the future that it is adding five new rigs to develop further its interests in the Permian.

Rig counts are rebounding. After hitting a peak of 1,609 in April, 2015, active rigs dropped to just 316 last June. Since then, however, 58 rigs have been brought back online — a gain of almost 20 percent in two months. And when new rigs are called for, new technology will bring them online in less than 135 days.

Continental Resources, Harold Hamm's company, is planning to increase its capital investment and expects its production to increase by 10 percent next year. Whiting Petroleum, the biggest shale oil developer of the Bakken formation in North Dakota, has said it would start deploying new rigs shortly as well. Hess Corporation, which also is developing Bakken, has cut its production costs by nearly 30 percent in just the last year.

Not only is the North American oil industry cutting its costs, it is extending the life of its existing wells.

And it has an estimated 3,900 DUC wells — drilled but uncompleted — just waiting for the breakeven point to drop enough to make them profitable.

Further declines in the price of crude are being predicted by action in the futures markets. Short positions poised to profit from further declines in the price of oil have just posted the largest increase going back to 2006. At the same time inventories continue to build, with stockpiles of oil held in commercial storage large enough to meet all of America's domestic demand for more than 70 days. Put another way, those reserves would keep the country humming for more than two months even if every other oil spigot were somehow to be turned off.

This is putting pressure on the wholesale price of gas, making retail gas less expensive, increasing its demand. Gas prices below $2 a gallon are once again showing up across the land.

All of which is putting OPEC, and particularly Saudi Arabia, into a financial bind. Its net foreign reserves have dropped by 25 percent since it announced its gambit in November 2014. And it is borrowing an estimated $4 billion a month to keep its hemorrhaging from getting worse.

The Saudis, and their partners in the OPEC cartel, are facing an untenable situation: With oil selling at half of what they need to pay their bills, and the returning of operating rigs pressuring oil prices while expanding oil inventories, they have painted themselves into a corner. If they cut production, they will lose market share, which will happily be taken from them by American producers. If they keep producing at maximum, oil prices will continue to decline, worsening their cash flow situation.

No longer the big dog in the oil patch, OPEC is watching its influence diminish daily, thanks to American producers continuing to find ways to produce more for less. This also bodes well for the American consumer, not only at the gas pump but in the price of the more than 6,000 other consumer goods made from oil.

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