

# Why the OPEC-Russia Blowup Sparked All-Out Oil Price War



First Russia tossed a hand grenade into global oil markets. Then Saudi Arabia dropped a bomb. After the dramatic collapse of an alliance between the OPEC oil cartel and Russia, a one-day plunge of more than 30% in oil prices sent shockwaves through global financial markets already reeling from the fallout of the coronavirus epidemic. The blowup of Russia's deal with the 13-member club of oil exporters – an alliance that has underpinned world oil prices for three years – triggered a sudden price war.

## 1. What's the bustup?

Russia had joined forces with OPEC in 2016, along with nine other non-member countries, and the alliance controlled almost half of the world's oil production. The "OPEC+" pact led to a resurgence of the cartel, which wields immense power over the world's most critical commodity. Russia stunned oil traders when it refused to go along with production cuts pushed by Saudi Arabia at a March 6 meeting in Vienna. The kingdom –

OPEC's biggest producer and its driving force – wanted to trim output further to prop up prices as the coronavirus ravaged energy demand. Saudi Arabia responded aggressively just hours later: Its state-owned oil behemoth said it would reverse course on March 8, open the taps and slash crude prices.

## **2. What led to the fallout?**

Talks between Russia and the Organization of Petroleum Exporting Countries broke down because the country didn't want to be strong-armed into further cuts to its lucrative oil production. It complained that the OPEC+ deal had aided America's shale industry. Russia was also increasingly angry with the willingness of U.S. President Donald Trump to employ energy as a political and economic tool. It was irked by the use of U.S. sanctions to prevent the completion of a pipeline linking Siberia's gas fields with Germany, known as Nord Stream 2.

## **3. What does this have to do with shale?**

The Kremlin was reluctant to cede further market share to U.S. shale drillers – known as frackers – that have been adding millions of barrels of oil to the global markets. An attack on shale has been tried before: When the new technique was expanding in 2014, Saudi Arabia's strategy was to flood the market, expecting that a collapse in prices would thwart the new competition. As shale producers found cheaper ways to operate and a global supply glut dragged on, OPEC then returned to its traditional tool of constraining output, sending oil to a four-year high of more than \$85 a barrel by mid-2018. The victory proved self-defeating. Higher prices re-invigorated U.S. fracking, propelling the U.S. to overtake Saudi Arabia and Russia as the world's No. 1 crude producer. Many drillers in Texas and other shale regions look vulnerable, as they're overly indebted and already battered by rock-bottom natural gas prices.

## **4. Can Russia and Saudi Arabia live with lower prices?**

That remains to be seen – the two sides could always return to the negotiating table. In the short run, Russia is in a good position to withstand a price slump. Its government budget breaks even at a price of \$42 a barrel and it has squirreled away billions of dollars in a rainy-day fund. Saudi Arabia, which is almost entirely dependent on oil to fund lavish government spending, holds about \$500 billion in foreign currency reserves to cushion the blow. One source of potential stress: The kingdom's currency, the riyal, has been pegged to the U.S. dollar for more than three decades, providing economic and financial stability. OPEC has a built-in competitive advantage, since its Middle Eastern members can produce crude at about a third of the cost of U.S. shale.

## **5. What about other countries?**

Such a dramatic crash in the price of oil, if it were sustained, would savage national budgets of petro-states from Venezuela to Iran, threatening to upend politics around the world. To policy makers, volatile oil prices are an added complication as they try to shield economies from the impact of the coronavirus epidemic.

## **6. What's the wider fallout?**

There are winners from rock-bottom oil prices – among them China, the world's largest oil importer, whose recovery from the virus will be key for the global economy. The U.S. – once a beneficiary of low oil prices – is now an exporter rather than a buyer. Sudden surges in oil prices are feared because of the way they could jack up costs across the global economy and slow economic growth. Now a world reeling from an economic slump triggered by the virus is enduring another sort of oil shock.

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# Shale's New Reality: Almost All Wells Drilled Now Lose Money



America's shale producers already had a profitability problem. It just got a lot worse.

At a stroke, Saudi Arabia and Russia and their battle for market share have made almost all U.S. shale drilling unprofitable. Only five companies in two areas of the country have breakeven costs lower than the current oil price, according to data compiled by Rystad Energy, an Oslo-based consultancy.

Wells drilled by Exxon Mobil Corp., Occidental Petroleum Corp. Chevron Corp. and Crownquest Operating LLC in the Permian Basin, which stretches across West Texas and southeastern New

Mexico, can turn profits at \$31 a barrel, Rystad's data show. Occidental's wells in the DJ Basin of Colorado are also in the money at that price, which is where oil settled Monday.

But that's not the case for the rest of the shale industry – more than 100 operators in a dozen fields. For them, drilling new wells will almost certainly mean going into the red.

Shale projects are heralded for their ability to be quickly ramped up and down. But because output from these wells declines much faster than from their old-school, conventional cousins, companies have to drill more of them just to keep output flat. That has meant sluggish investor returns, one of the main reasons oil and gas represents less than 4% of the S&P 500 Index.

At this point, “companies should not be burning capital to be keeping the production base at an unsustainable level,” said Tom Loughrey, a former hedge fund manager who started his own shale-data firm, Friezo Loughrey Oil Well Partners LLC. “This is swing production – and that means you’re going to have to swing down.”

Already, producers including Diamondback Energy Inc. and Parsley Energy Inc. have said they’re cutting their drilling budgets and dropping rigs. Others, such as Apache Corp. and Occidental, have indicated they’ll rein in activity.

“What they’re not saying is that they’re going to suspend activity,” Loughrey said.

In his view, a typical well in the Midland sub-basin of the Permian requires \$68 oil for investors to make an adequate return within 24 months.

BloombergNEF expects producers to move away from using breakeven costs that leave out overhead and other necessary expenses as investors shift their focus to cash flow.

"At a minimum, they will need to add back interest costs to their calculus," BloombergNEF said in a report. That means the profitability floor for most new wells will rise to \$50 a barrel "in the not too distant future," according to the report, up from \$45 in the past.

The shale boom turned the U.S. into the biggest oil producer in the world and, in recent months, a net exporter of petroleum. But if prices remain near \$30 a barrel, producers will be forced to ax so much drilling activity that U.S. oil production could fall by 2 million barrels a day from the end of this year to the end of next, according to Rystad.

That would be about a 20% drop.

On Monday, West Texas Intermediate crude fell 25% to settle at \$31.13 a barrel, and some forecasters see it falling toward \$20. Prices clawed back some of those losses Tuesday, reaching as high as \$33.73.

"Even the best operators will have to reduce activity," said Artem Abramov, head of shale research at Rystad. "It's not only about commerciality of the wells. It's a lot about corporate cash flow balances. It's almost impossible to be fully cash flow neutral this year with this price decline."

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## IEA: Oil Demand To Drop For First Time Since 2009



Global oil demand is set to drop this year for the first time since the financial crisis in 2009, the International Energy Agency (IEA) said on Monday, as it slashed its demand outlook by 1.1 million bpd due to the coronavirus outbreak and its impact on economies.

The IEA now sees global demand falling by 90,000 bpd year on year in 2020, the agency said in its Monthly Oil Market for March 2020, after its executive director Fatih Birol warned two weeks ago that the coronavirus outbreak could hit global oil demand growth more than initially expected.

In the February market report, the IEA had slashed its 2020 oil demand growth forecast by 365,000 bpd to just 825,000 bpd—the lowest oil demand growth since 2011, and warned that the coronavirus outbreak would lead to the first quarterly contraction in global oil demand in more than 10 years.

In view of the global spread of the coronavirus and its impact on the global economy, the agency now expects full-year oil demand to drop.

“While the situation remains fluid, we expect global oil demand to fall in 2020 – the first full-year decline in more than a decade – because of the deep contraction in China, which accounted for more than 80% of global oil demand growth in 2019, and major disruptions to travel and trade,” the IEA said in its March report.

The report commented on the collapse of the OPEC+ coalition, saying that the implication is that “the OPEC+ countries will be free to exercise their commercial judgement when assessing future levels of production.”

The IEA report comes a day after Saudi Arabia effectively launched an oil price war on Russia after the former allies abruptly ended the OPEC+ agreement last Friday. Over the weekend, the Saudis slashed their official selling prices by \$6-7 a barrel to all markets including Asia, and signaled they would boost production as of April, sending oil prices into a tailspin on Monday to the biggest fall since 1991.

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## **How oil's plunge might end up boosting US natural gas prices**



A sharp reduction in shale oil drilling because of crude's crash could end up boosting US natural gas prices and potentially curb an oversupply in the global market for liquefied natural gas.

Oil markets have crashed by almost a third to less than \$35 a barrel after the disintegration Friday of the Opec+ alliance, which has triggered a price war between Saudi Arabia and Russia. If the plunging price discourages shale oil drilling,

the knock-on effect could be a cut in the supply of gas extracted as a byproduct, according to Goldman Sachs Group Inc.

If shale producers invest on the basis of \$30-\$45 per barrel of crude over the next 5 quarters, there will be about 1bn cubic feet a day less US gas production, said Goldman analysts including Brian Singer. That's about 1% of US daily natural gas output in December.

"US producers tend to respond to prices with a lag of a couple of months, though we see the response time narrowing, given flexibility of shale and greater focus on free cash flow," the Goldman analysts said.

Front-month US gas futures fell as much as 9.8 cents, or 5.7%, to \$1.610 per million British thermal units, the lowest intraday level since August 27, 1998. Prices losing just 1/10th of a cent from there would put it at the lowest since September 1995.

The US is brimming with gas as production booms. This has been particularly acute in the Permian formation, where prices for gas extracted from oil drilling have tumbled below zero, meaning producers will pay others to take the fuel off their hands. Output from the West Texas and New Mexico shale play is rising faster than pipelines can be built to carry it away.

In Europe, which has boosted imports of US LNG, front-month benchmark Dutch prices were down 3.2% Monday after earlier falling as much as 5.8%.

If European gas prices "were to drop any further, we should see a downward adjustment in LNG exports from the US to Europe as exporters of spot cargoes would not be covering their operational costs," said Carlos Torres Diaz, head of gas and power markets at Rystad Energy AS.

The plunge in oil may turn the global gas industry on its head. Gas supply contracts linked to oil prices, which have been out of favour as gas dropped faster than oil, will probably become attractive again. "You could certainly see gas prices in the US supported by low oil prices," said Ciaran Roe, global director of LNG at S&P Global Platts, in an

interview. Last year's view where oil linkages were frowned upon "looks to be receding into the rear-view mirror."

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## Oil prices plunge, hit by erupting Saudi-Russia oil price war



NEW YORK – Oil prices crashed on Monday, suffering their biggest daily rout since the 1991 Gulf War, after the collapse of an OPEC+ supply agreement that now threatens to overwhelm the world with oil, inciting panic throughout the energy sector.

After failing to come to an agreement to cut supply, Saudi Arabia and Russia over the weekend pledged instead to ramp up

production, which could quickly flood global markets with oil at a time when demand has already weakened substantially.

The market's reaction has been furious, with crude futures plunging by nearly 20%, while energy stocks collapse as shale producers frantically cut future expenditures in anticipation of a drastically different outlook than a few days ago.

Brent crude futures were down \$8.84, or 19.5%, to \$36.43 a barrel by 10:49 a.m. EDT (1449 GMT). They earlier fell by as much as 31% to \$31.02, their lowest since Feb. 12, 2016.

U.S. West Texas Intermediate (WTI) crude fell \$7.81, or 18.9%, to \$33.47 a barrel. WTI earlier dropped 33% to \$27.34, also the lowest since Feb. 12, 2016.

Should these losses hold, it would be the biggest one-day percentage decline for both benchmarks since Jan. 17, 1991, the outset of the U.S. Gulf War, when it fell by a third.

A three-year supply pact between members of the Organization of the Petroleum Exporting Countries, which includes the group's top producer Saudi Arabia, and Russia fell apart on Friday after Moscow refused to support deeper oil cuts to cope with the outbreak of coronavirus.

OPEC responded by removing all limits on its own production, prompting fear of a supply hike in a market already awash with crude.

Despite sliding demand for crude due to the coronavirus, Saudi Arabia plans to boost its crude output above 10 million barrels per day (bpd) in April after the current deal to curb production expires at the end of March, two sources told Reuters on Sunday. Saudi Arabia also cut its official crude selling price.

The kingdom has been producing around 9.7 million bpd in recent months.

Russia, one of the world's top producers alongside Saudi Arabia and the United States, also said it could lift output and that it could cope with low oil prices for six to 10 years.

The countries along with several other producers have cooperated for three years to restrain supply. The OPEC+ talks collapsed after OPEC effectively presented Russia with an ultimatum on Thursday, offering it a choice of accepting a deal with much bigger than expected cuts or no deal at all.

"The prognosis for the oil market is even more dire than in November 2014, when such a price war last started, as it comes to a head with the significant collapse in oil demand due to the coronavirus," Goldman Sachs said.

Saudi Arabia, Russia and other major producers last battled for market share in 2014 in a bid to put a squeeze on production from the United States, which has not joined any output limiting pacts and which is now the world's biggest producer of crude.

The global outbreak of the coronavirus prompted OPEC to seek additional output cuts. More than 110,000 people have been infected in 105 countries and territories and 3,800 have died, the vast majority in mainland China, according to a Reuters tally.

China's efforts to curtail the coronavirus outbreak has disrupted the world's second-largest economy and curtailed shipments to the biggest oil importer.

The International Energy Agency said on Monday oil demand was set to contract in 2020 for the first time since 2009. It cut its annual forecast by almost 1 million bpd and that the market would now contract by 90,000 bpd.

Major banks also have cut their demand growth forecasts. Morgan Stanley predicted China would have zero demand growth

in 2020, while Goldman Sachs sees a contraction of 150,000 bpd in global demand.

Bank of America reduced its Brent crude price forecast from \$54 a barrel to \$45 a barrel in 2020.

"The radical shift in policy suggests that Saudi will allow inventories to build sharply over the next three quarters," said a Bank of America Global Research report. "As a result, we now expect Brent oil prices to temporarily dip into the \$20s range over the coming weeks."

(Additional reporting by Dmitry Zhdannikov in London, Aaron Sheldrick in Tokyo, Scott DiSavino in New York and Shu Zhang in Singapore; Editing by Marguerita Choy and Edmund Blair)

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## **US gas export pioneers forced to sell shares amid market slump**



Two pioneers of the U.S. natural gas export industry were forced to sell shares of the company they founded amid a global market rout and concern that a key supply deal won't be finalized.

Tellurian Inc. Chairman Charif Souki and Vice Chairman Martin Houston sold 4 million and 3.4 million shares respectively, according to filings late Friday. In both cases, the transactions were forced by a lender to satisfy loan requirements, the filings show. Tellurian declined to comment.

Shares of the company, which is trying to develop a \$28 billion liquefied natural gas terminal in Louisiana, plunged by more than half on Friday to close at \$1.80. The total weekly decline was 72%.

India's Petronet LNG Ltd., a potential major customer that Tellurian has courted, announced earlier this week it would seek competing offers. The move highlights the mounting

pressure on sellers amid a worldwide glut, and adds to doubts that Tellurian will be able to secure a sizable anchor investment from Petronet for its Driftwood LNG project. The Petronet news also dashed hopes that the two companies might finalize a supply agreement during President Donald Trump's visit to India this week.

The coronavirus outbreak, meanwhile, sent global markets spiraling lower, adding to Tellurian's woes. The epidemic has hit China, South Korea and Japan, the world's biggest LNG importers, particularly hard.

"Continued commercial slippage, mounting liquidity concerns, and the broader market de-risking have combined to price-in the new economic reality for Tellurian: It's not going to make it," Michael Webber, managing partner at Webber Research & Advisory LLC, wrote in a note to clients Friday.

Tellurian said Thursday it had extended a memorandum of understanding with Petronet by two months to May 31. Under the memorandum, Petronet agreed to negotiate the purchase of as much as 5 million tons a year of LNG from Driftwood, along with an equity investment.

Collapsing LNG prices in Asia and Europe have squeezed profits for American gas exporters, already under pressure after China halted U.S. imports of the fuel a year ago amid trade tensions. Without commitments from Chinese buyers, some American export projects may be delayed or canceled.

Souki is the founder of Cheniere Energy Inc., the biggest U.S. LNG exporter, and served as its boss before being forced out. Houston was chief operating officer at BG Group Plc and was the key architect of its LNG business. BG, which has since been acquired by Royal Dutch Shell Plc, signed the first purchase agreement with Cheniere in 2011.

Souki is worth about \$500 million, according to the Bloomberg Billionaires Index. That's largely from collecting money from shares sales of Cheniere.

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# Libya economic experts to study oil revenue sharing, says UN



Libyan economic experts will study the distribution of crucial oil revenue as efforts continue to solve the war-ravaged OPEC member's political crisis, the United Nations said.

The decision to assign the economic commission to work "on issues of immediate concern," which also include a banking crisis, came after meetings in Cairo this week attended by representatives from across Libya's political spectrum as well as economists and other academic experts. The experts agreed to meet again in early March, the UN mission in Libya said Tuesday in a statement.

The oil market had been closely monitoring the talks for any sign of a deal to restore output in the North African nation after supporters of eastern commander Khalifa Haftar forced

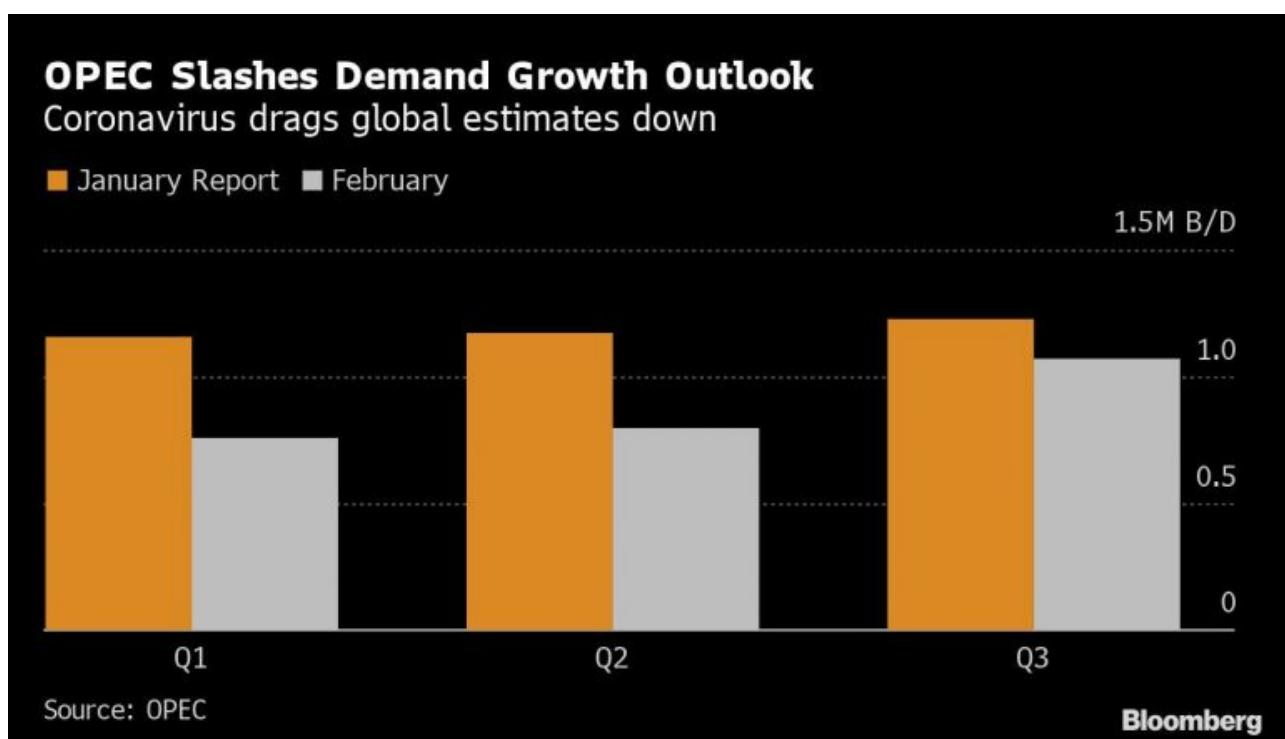
ports to close mid-January, driving daily output down to about 180,000 barrels, its lowest since the 2011 uprising against long-time leader Moammar Qaddafi.

Imminent large-scale resumption, although unlikely, could add over 1 million barrels per day to the international market, complicating OPEC's efforts to assess the impact of the coronavirus on demand.

The talks were the latest in a series of global efforts to end the conflict between the internationally recognized government in Tripoli and Haftar, whose forces control the oil-rich east and south and in April turned their sights on the capital.

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## Opec slashes oil demand forecast as virus threatens new glut



OPEC slashed forecasts for global oil demand as the coronavirus hits fuel use in China, leaving the group facing a renewed glut despite its recent production cuts.

The cartel reduced projections for demand growth in the first quarter by 440,000 barrels a day, or about a third, in its monthly report. Oil prices sank to a one-year low on Monday as the infection leaves businesses idle and millions quarantined in the world's biggest crude importer.

Oil's slump has spurred the Organization of Petroleum Exporting Countries' biggest exporter, Saudi Arabia, to press fellow members and allies to hold an emergency meeting and consider new output cutbacks. Yet the proposal has so far met resistance from Russia, the group's most important ally, which is able to weather lower prices more easily.

The report showed that, even though many OPEC members made a strong start with fresh output curbs that took effect last month, the virus' impact on consumption will leave them with a new overhang.

The group collectively pumped 28.86 million barrels a day in January, and if it maintains that rate there will be a surplus of 570,000 barrels a day during the second quarter, when consumption slows down seasonally. The monthly report is compiled by OPEC's Vienna-based research department.

OPEC doesn't see the effects of the disease confined to the start of the year, bringing down its growth estimate for global oil demand in 2020 as a whole by about 230,000 barrels a day to just under 1 million a day. Still, the increase remains slightly higher than last year's.

Though crude futures have recovered on speculation the spread of the disease could be nearing its peak, prices of about \$55 a barrel in London remain well below the levels most OPEC members need to cover government spending.

Since the producer group formed an alliance with non-members such as Russia three years ago, the coalition has restrained supplies to offset a surge of production from the U.S. shale industry, and keep prices supported. They embarked on a new round of cutbacks in January.

Last week, a committee of technical experts from the alliance, known as OPEC+, recommended reducing output by a further 600,000 barrels a day to offset the impact of the coronavirus. Russia, however, says it's "studying" the proposal and its energy minister, Alexander Novak, is consulting with oil companies today.

OPEC's latest outlook may encourage them to give greater consideration to taking additional measures.

"Clearly, the ongoing developments in China require continuous monitoring and assessment to gauge the implications," the report said.

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**Permian gas-flaring is much worse than previously thought**



The burning and releasing of vast amounts of natural gas into the atmosphere in America's top shale basin is much bigger than previously thought when processing plants are included, Rystad Energy found.

Research on the controversial practices of flaring and venting – described by shale pioneer Scott Sheffield as a “black eye” for the Permian Basin – has typically focused on emissions by oil producers at the wellhead.

But gas-processing facilities in the region are receiving more gas than they can handle, so they burned off or released about 190 million cubic feet per day of the fuel last year, raising the total by 30% to roughly 810 million, data from Oslo-based Rystad shows. That's almost enough gas to supply 5 million U.S. homes.

“With the inclusion of estimates for gas plant-related flaring, we observe a significant increase in total Permian

flaring and venting compared to our previous update," the consultancy said in a report.

The silhouette of an electric oil pump jack is seen near a flare at night in the oil fields surrounding Midland, Texas.

Flaring has become a major source of negative attention for Permian oil producers in Texas and New Mexico as concerns about greenhouse-gas emissions and climate change grow among consumers and investors. Permian drillers burn or release the gas that comes out of wells as an unwanted byproduct because they lack pipelines to send it where it's needed.

Rystad, a leading provider of flaring and venting data, uses information from the U.S. Environmental Protection Agency, the Texas Railroad Commission, which regulates oil and gas in the state, and its own estimates.

Ryan Sitton, one of the regulator's three commissioners, plans to release a first-of-its-kind report on flaring next week to give the public better information. The commission's reporting has been criticized as "outdated" and "difficult-to-manipulate" by the Environmental Defense Fund.

The dearth of good-quality data means that total flaring volumes are likely underreported, according to Rystad. Of the Permian's 50 smallest operators, only seven posted any flaring at all, meaning there are "obvious gaps" in the data, the consultancy said.

"This implies energy regulators might need to enforce better waste gas reporting standards to ensure that the market has sufficient fact-based visibility on the total volume of flared gas in the Permian," Rystad said.

Texas regulators have come under pressure from environmentalists and some larger oil producers for allowing the industry to burn off gas at record levels in the Permian. While safer and cleaner than letting methane vent unchecked

into the air, flaring produces carbon dioxide and wastes a useful resource. Opponents say producers should not be allowed to flare at will, and should not be allowed to drill wells unless they have a plan for their gas.

[Click here for more on the commission's planned report](#)

The Texas Railroad Commission says the increased flaring is primarily a result of surging crude production in the basin. The amount of gas flared as a portion of total production in Texas is much lower than other major oil producers such as Russia or states like North Dakota, Sitton said last week.

Still, if the Permian were a country, it would have ranked ninth for total volume of flared gas in 2018, ahead of Mexico and Angola and just behind Libya.

Including processing plants, the Permian flares about 5.5% of its gas, down slightly from a year ago, Rystad said.

*– With assistance by Rachel Adams-Heard*

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## **Norway vows to keep pumping gas as prices fall**



Europe's second-largest gas supplier plans to keep pumping natural gas even after prices dropped to their lowest in more than a decade. The region's benchmark slid 50% in the past year after a mild winter left inventories brimming and more cargoes of liquefied natural gas flooded the market. Yet that's not putting off Equinor ASA, the Norwegian state-owned producer, which delivers about a fifth of the European Union's pipeline gas imports. "If someone is hoping for supply relief coming from Norway, we will have to disappoint them," Tor Martin Anfinnsen, the state-owned company's senior vice-president for marketing and trading, said in an interview in Essen, Germany. "We will be the last ones to turn off the taps. We are far away from reducing flows." The unwillingness to cut flows may seem surprising, considering that Equinor is one of the most exposed oil companies to European and US spot

natural gas prices, according to Sanford C Bernstein & Co, which sees the company's gas earnings fall by about €300mn (\$326mn) in 2020 if prices don't change from current levels. But both Equinor and its larger Russian rival Gazprom PJSC may be focusing on preserving market share as competition heats among LNG suppliers. Equinor's gas production "is very cost-competitive," Anfinnsen said. The company said it continues its normal practice, which is to optimize prompt versus forward markets according to demand signals within the flexibility limits under its license permits. Norway's pipeline exports of natural gas to continental Europe and the UK fell to 107bn cubic meters in 2019 from 114bn cubic meters the year before as Equinor and other producers choose to hold back volumes amid the bad market conditions, according to Norwegian Petroleum Directorate. Benchmark next-month gas in the Netherlands has dropped to about €8.70 a megawatt-hour (\$2.75 a million British thermal units), the lowest since August 2009. Norway's marginal production cost is about €6 a megawatt-hour and Russia's is around €8, according to six traders and analysts consulted by Bloomberg since Tuesday at the E-World conference in Essen, Germany. "Even if prices achieve levels below Norway and Russia's marginal cost of production, these countries usually have long-term strategies for gas supply," Frank van Doorn, head of trading at Sweden's Vattenfall AB, said in an interview in Essen. "I am not sure if they would have a quick answer to low prices." Even the coronavirus may weigh down on European gas if more Chinese buyers declare force majeure on LNG supplies, leaving the potential for increased imports of the chilled fuel into the region, van Doorn said. "It is hard to find a bullish factor for natural gas right now," he said. "It can take more than two years until we see an upside move."