

COVID-19 crisis: Will the US shale industry sail through the global oil industry's biggest crisis in 100 years?

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The global oil and gas industry is in a deep crisis due to the impact of both demand-side and supply-side shocks. The demand-side shock is driven by the coronavirus pandemic, which has resulted in global oil demand collapsing due to widespread measures to contain it, such as lockdowns and travel restrictions. The supply-side shock is driven by the collapse of an OPEC+ supply deal to cut oil production that has led to a pricewar between Saudi Arabia and Russia. Global crude oil benchmarks have, as a result, plummeted by more than 55% YTD, with prices currently hovering at USD25-35/bbl. Regional crude oil prices in West Texas and North Dakota have fallen even further, to around USD15/bbl. Hence, we believe the US shale industry is looking at the biggest global oil market crisis in the past 100 years¹. Despite the significant headwinds, we expect it to weather the current crisis due to the factors mentioned below.

Limited availability of oil storage capacity would force production shut-ins globally. Most countries are in lockdown in efforts to contain the spread of COVID-19, and oil demand is expected to contract by around 20 million barrels a day (MMbbl/d) in 1H202. Additionally, Saudi Arabia, Russia and a few OPEC members are expected to significantly ramp up production amid the pricewar. Surplus oil is, therefore, expected to exceed 1.8 billion barrels (Bbbl) by the end of 1H202, soon using up the world's limited available storage capacity, estimated at around 1.6 Bbbl by industry research firm IHS Markit². IHS Markit expects up to 10 MMbbl/d³ of global production capacity to be forced to shut in in 2Q20, as production cannot continue once storage capacity is full.

US shale industry is well positioned to boost production at short notice when global oil production declines and prices rebound in 2H20. As a result of forced production shut-ins, global oil production would start to decline by end-1H20 until early 2021. The potential production shut-ins would also have long-term consequences, as they could damage oil wells and reservoirs, making it difficult to bring them back online to full capacity when demand picks up. This would result in oil shortages in the coming years and oil prices rebounding sharply by end-2020 when demand picks up and supply lags, as usual. The US shale industry would be well positioned to benefit from the oil market rebound, as it can resume production with limited lost capacity at very short notice due to the industry's high-pressure wells and shorter drilling cycles.

Industry consolidation and digitalisation of oil fields to further improve cost efficiencies of shale wells. We expect the challenging oil price environment to spark a wave of bankruptcies in the US industry and lead to industry consolidation through mergers and acquisitions. The bigger surviving players will likely consolidate the industry's high-quality assets and shed unproductive assets, resulting in higher economies of scale. Additionally, the US shale industry has started adapting digital technology at all phases of the well lifecycle; this is expected to further increase the cost efficiency and productivity of shale wells. Lastly, hundreds of start-ups and big technology companies, including Microsoft, Google, and Amazon, are developing cutting-edge oil field digital technologies to accelerate the digitalisation of oil fields.

We believe COVID-19 will have a deep impact on how we do business around the world. The US shale industry is already facing a crisis to deal with the contracting oil demand. The businesses will need to build resilience and adapt to this new normal of business as they rethink their strategy for 2020.

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To help our clients navigate both the people and business impact of COVID-19, we have created a [dedicated hub](#) containing a variety of topics including our latest thinking, thought leadership content and action oriented guides and best practices.

Sources:

1. <https://www.ft.com/content/7afb4c04-6d58-11ea-89df-41bea055720b>

2. <https://www.marketwatch.com/story/the-world-is-running-out-of-tanks-to-store-oil-as-coronavirus-and-price-war-lead-to-flood-of-crude-2020-03-26>

3. <https://www.worldoil.com/news/2020/3/31/ihs-markit-sees-forced-oil-production-cuts-of-10mmbpd-ahead>

4. <https://www.worldoil.com/news/2020/4/1/goldman-sachs-sees-shale-ultimately-victorious-in-the-oil-war>

5. <https://www.city-journal.org/coronavirus-american-shale-industry>

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