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Saudi Oil Price Cut Is a Market Shock With Wide Tremors

Oil producers in the United States and other nations brace for lower revenue, reduced investment and job losses as a global glut is compounded.

By Clifford Krauss

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HOUSTON — The sudden upheaval in the oil markets may claim victims around the world, from energy companies and their workers to governments whose budgets are pegged to the price of crude.

The fallout may take months to assess. But the impact on the American economy is bound to be considerable, especially in Texas and other states where oil drives much of the job market.

With the coronavirus outbreak slowing trade, transportation and other energy-intensive economic activities, demand is likely to remain weak. Even if Russia and Saudi Arabia resolve their differences — which led the Saudis to slash prices after Russia refused to join in production cuts — a global oil glut could keep prices low for years.

Many smaller American oil companies could face bankruptcy if the price pressure goes on for more than a few weeks, while larger ones will be challenged to protect their dividend payments. Thousands of oil workers are about to receive pink slips.

The battle will impose intense hardship on many other oil-producing countries as well, especially Venezuela, Iran and several African nations, with political implications that are difficult to predict.

The only winners may be drivers paying less for gasoline — particularly those with older, less fuel-efficient cars, who tend to have lower incomes.

“What a day, what a time,” said Daniel Yergin, the energy historian and author of “The Prize: The Epic Quest for Oil, Money and Power.” “This is a clash of oil, geopolitics and the virus that together have sent the markets spiraling down. The decline in demand for oil will march across the globe as the virus advances.”

Saudi Arabia and Russia are hurt by low prices and have reasons to compromise, but both have a cushion to absorb financial losses for a few months at least.

Saudi Arabia depends on high oil prices to fund its ample social programs, but it has the lowest production costs of any producer, so it can operate profitably even at lower prices. Russia has sufficient financial reserves and can devalue its currency, the ruble, to sustain the flow of money through its economy even when prices decline.

That leaves the higher-cost producers, and the service companies that drill for them, most immediately vulnerable. Diamondback Energy, a medium-size company based in Texas, slashed its 2020 production plans, cutting the number of hydraulic-fracturing crews to six from nine. Other companies are expected to follow suit in the coming days.

The operations in greatest jeopardy are small, private ones with large debts, impatient investors and less productive wells. Small companies — those with a couple of hundred wells or fewer — account for as much as 15 percent of American output, which has more than doubled over the last decade to roughly 13 million barrels a day.

But medium-size companies are also imperiled, including Chesapeake Energy, according to Morgan Stanley. Chesapeake, a major Oklahoma oil and gas company, has $9 billion in debt and little cash because of persistently low commodity prices.

Chesapeake did not immediately respond to requests for comment.

In an investment note on Monday, Goldman Sachs said that large companies like Chevron and ConocoPhillips would be prepared to handle the shock, but that Exxon Mobil could be forced to cut spending on exploration and new production, which has recently been focused on West Texas, New Mexico and the waters off Guyana.

Shares of Occidental Petroleum, deeply in debt from its acquisition of Anadarko last year, declined by more than 50 percent over concern that it would need to slash its dividend.

Halliburton and other service companies — the ones that do the drilling and hydraulic fracturing that blasts through shale rock — are exposed because explorers and producers frequently cut their services first during downturns.

On the other hand, refiners like Valero may benefit from increased supplies of cheap oil, according to Goldman Sachs. And there may be an upside for natural gas producers, because a reduction in oil production will mean less gas bubbling up from oil wells, bolstering prices.

American oil executives put the best face on the situation, noting that many reduced their risks over the last six months by hedging with sales contracts at $50 a barrel or higher. But they said layoffs were inevitable, as when oil prices plunged in late 2014 and 2015 and more than 170,000 oil and oil-service workers lost their jobs.

Companies can adjust their spending by drilling but not finishing their wells with hydraulic fracturing, leaving them ready to ramp up when prices recover. Still, oil analysts note that even a sharp decline in new wells would not reduce American oil production by more than a couple of million barrels a day over the next year or two.

Scott D. Sheffield, chief executive of Pioneer Natural Resources, one of the biggest Texas oil companies, predicted that Russia and Saudi Arabia would be hurt far more than American oil producers.

"We will all adjust our capital and employee work force to preserve balance sheets," Mr. Sheffield said. "Many companies will go bankrupt, but new shareholders will own the drilling locations."

The oil industry has dealt with sharp price declines several times in recent decades. Big oil companies invested through those cycles, especially with long-term projects such as deepwater drilling in the Gulf of Mexico and off Brazil and Africa.

Some analysts say the global industry may not be as well prepared for the latest challenge. Increased concerns about climate change and the growing reluctance of investors to pour money into a sector that has strained to make profits in recent years hobbled the industry even before the virus hit.

"In many respects, this time will be different, but not in a good way," said David L. Goldwyn, the top energy diplomat in the State Department during the first Obama administration. "Low oil prices will not necessarily result in increased demand due to the firm commitment of many countries to decarbonization. The uncertain trend line for coronavirus suggests demand recovery will be slow in coming."

The stock market plunge that has accompanied the drop in oil prices will hurt many Americans, but at least they will be paying less at the gasoline pump. The average regular gasoline price has declined by 5 cents over the last week, to $2.38 a gallon, according to the AAA motor club, and is 9 cents below a year ago.

Every penny drop means a roughly $4 million a day savings for American drivers, energy economists say.

President Trump grasped at the silver lining. “Good for consumer, gasoline prices coming down!” he [declared Monday on Twitter].

But Mr. Yergin, the energy historian, noted that “low gasoline prices don’t do much for you if schools are closed, you cancel your trip or you’re working from home because of the virus.”

And oil-producing states will suffer. Texas lost as many as 100,000 oil jobs the last time prices collapsed in 2014 and 2015, and some companies never replaced all their workers.

The state has diversified its economy since the 1990s, but restaurants, hotels and shopping malls in Houston and across the state still rely on the energy economy. Oil companies have already been laying off employees in recent months as crude prices sagged.

Internationally, the price drop will reverberate differently from country to country. China and India, as huge importers of oil, stand to gain.

But it’s a different story for Venezuela, a Russian ally that depends on its dwindling oil exports. The country is short of food and medicine, prompting many Venezuelans to leave for neighboring countries and the United States.

Iran, already under pressure from tightening American oil sanctions, will also be hurt by lower prices, adding to an economic burden that has led to growing discontent.

Saudi Arabia may also be hurt, even though it precipitated the crisis. Saudi government finances and social programs are based on oil sales, which are also meant to help diversify the economy.

Twenty percent of the Saudi population is invested in the national oil company, Saudi Aramco, after its [initial public offering last year]. With the prospect of reduced earnings, Aramco shares have fallen below their I.P.O. price.

“There could be a large number of disgruntled citizens,” said Ellen Wald, a Middle East historian and senior fellow at the Atlantic Council’s Global Energy Center.

Lower oil prices have a mixed impact on the environment. Drilling goes down, as do releases of methane, a powerful greenhouse gas connected with climate change. But if prices stay low for a while, gas-guzzling cars and trucks may find more buyers.

And as with any cycle, the question is how long it will last.

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https://www.nytimes.com/2020/03/09/business/energy-environment/saudi-oil-price-impact.html