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US shale surge overwhelms oil market as OPEC splits deepen

An oil pumpjack works at dawn in the Permian Basin oil field on January 20, 2016 in the oil town of Andrews, Texas

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Oil prices have plunged to the lowest level this year as US shale producers boost output at an astonishing pace and crude inventories keep rising, triggering a wave of selling by hedge funds with record speculative positions.

The US surge threatens to neutralise cuts agreed by the OPEC cartel and a Russia-led group of producers last November, potentially delaying a full recovery of the market until 2018 or even later.

Texas light crude fell $48.90 a barrel on Thursday after yet another surprise jump in US stocks. Prices have slid 8pc in three days and have broken through key levels of technical support, dousing enthusiasm for commodities across the board.

America's shale frackers have slashed cost so far that they can now produce large volumes at a break-even price of $35 or lower in the prolific Permian Basin, the twelve-layered 'crown jewel' of West Texas, where land auctions have reached $60,000 an acre in core zones.

Continental's legendary wild-catter Harold Hamm said drilling is coming back so fast, and on such a large scale, that it threatens to overwhelm the global industry. "We are on something of an equal basis today with OPEC. We need to be careful not to overproduce. It has to be done in a measured way or else we'll kill the market," he said at the CERAWeek energy forum of IHS Markit in Houston.

The US rig count has almost doubled to 756 since touching bottom last May. The productivity per rig has soared as longer lateral drills, "geological steering", and precision "clustering" triple extraction rates in some sweet spots. The decline rate of the wells has dropped from 65pc to 35pc a year since 2013.

“The consequence has now become alarmingly visible. US crude oil production is growing. And it is growing strongly," said Bjarne Schieldrop from SEB.

Fatih Birol, executive director of the International Energy Agency

Raghdaa Hasan from Statoil said US producers have restored almost all the losses of the slump in just four months, lifting production by over 500,000 b/d. "US shale has proved itself really resilient. They are able to pour significant output into the global system," she said at CERAWeek.

"At $50, we expect a major ramp up, with an extra 400,000 (b/d) in 2018 and then 600,000 each year after that," she said.

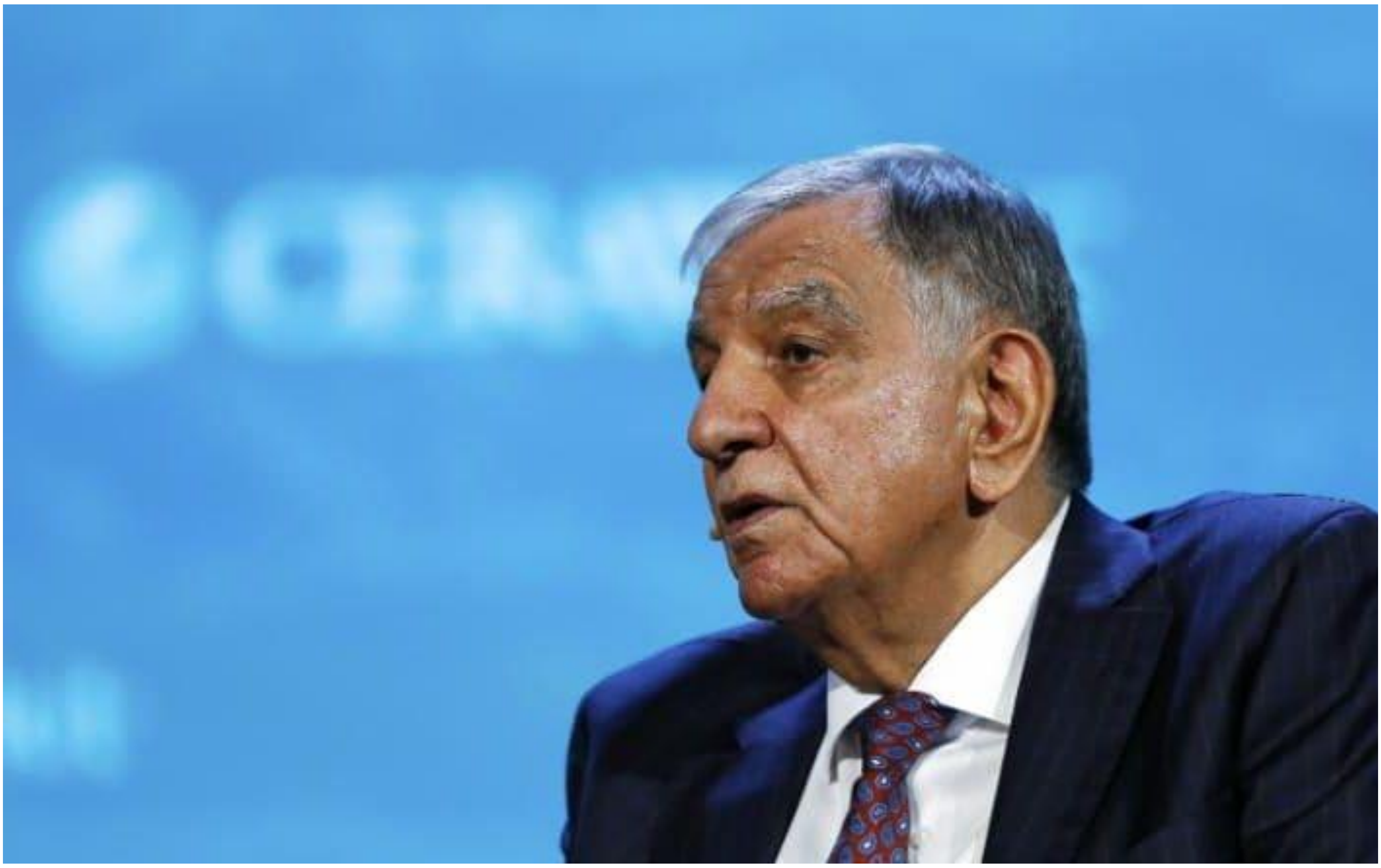
What is unsettling for OPEC is that the resurgence is not confined to the Permian. There is a revival in several fields thought to be in decline. Anadarko's president Al Walker said his company was making 'Permian-style' gains at his sites in Colorado, where the US Geological Survey estimates that there may be 40 times more oil than originally supposed.

Fatih Birol, head of the International Energy Agency, told the forum that America's frackers could add 3m b/d to world supply over the next five years, pushing shale volumes towards a once unthinkable eight million if prices remain buoyant.

"We are witnessing the start of a second wave of a US shale oil supply growth. This second wave is unmistakable," he said. This is a significant change in tone. The IEA has tended to be a shale sceptic in the past, and has been caught off guard repeatedly.

The shale rebound has combined with events in the Middle East to seriously rattle the day-to-day oil markets. The Iraq's oil minister, Jabbar Ali Al-Luiebi, stunned traders with predictions at CERAWeek that his country would lift output by almost a million barrels a day (b/d) to 5m in the second half of this year.

Such an expansion would further flood the global market before it has come close to rebalancing. It is matched by similar rhetoric from Libya, which has already doubled output to 700,000 over recent months and is ultimately eyeing 2.2m b/d.



Jabbar Ali Al-Luiebi, Iraq's oil minister

Mr Al-Luiebi's off-the-cuff comments provoked consternation in the audience. "We have a pipeline capability of 6.5m and we have a target of 7m. We have discovered 74 oil fields and only half of these have been developed," he said.

The Iraqi push comes amid mounting signs of tension within OPEC over the need for an extension of the cuts when the deal expires in June. Saudi Arabia's energy minster Khalid al-Falih said in Houston that "free riders" were taking advantage of lower output by the core Gulf states to violate the pact, and in some cases to raise production.

"Saudi Arabia will not allow itself to be used by others. The agreement is for the benefit of all, and needs to be addressed by all," he said. It is not clear whether he regards Russia as one of the villains. Traders say the Kremlin has not come close to delivering the 300,000 b/d cuts promised.

Mr al-Falih said the agreement was for a limited time only and warned US shale producers and others betting on a fresh boom that the Kingdom would not "underwrite their investments" by holding back supply.

It had been assumed that the Saudis would do whatever it takes to push oil back up to a band of $60 to $70 in order to smooth the way for a $100bn part-privatisation of the state oil giant Aramco next year, the biggest public offering ever. This is no longer so certain.

Patrick Pouyanné, chairman of the French group Total, said OPEC is going to have to bite the bullet and accept much longer cuts. "The fact is, we still have build-ups in U.S. inventories. If OPEC wants to rebalance the market, then they'll have to extend the agreement. It will take a year to 18 months to really have an impact on inventories," he said in Houston.

That is a grim prospect for a string of OPEC countries that still need triple-digit oil prices to balance their budgets. They may to have burn through foreign exchange reserves for much longer than they ever imagined, or tighten their belts even harder.