https://www.wsj.com/articles/covid-19-makes-oil-markets-sweat-11583856025

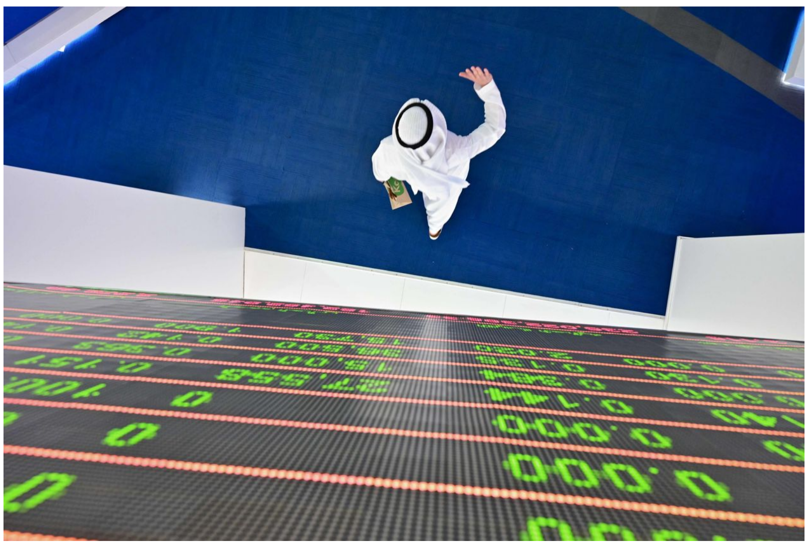
OPINION | COMMENTARY

Covid-19 Makes Oil Markets Sweat

Russia's push for lower prices gets a boost from a demand shock. Can U.S. shale producers survive?

By Daniel Yergin

March 10, 2020 12:56 pm ET



A trader at the Dubai Stock Exchange, March 8.

PHOTO: GIUSEPPE CACACE/AGENCE FRANCE-PRESSE/GETTY IMAGES

The oil-exporting alliance between Saudi Arabia and Russia collapsed on Friday after almost four years. The OPEC+ deal, which the two countries brokered in 2016 after a debilitating 2014 price collapse, is over, called off by the Russians. Result: a free-for-all in the world oil market, lower prices and a battle for market share. The No. 1 target in Russia's crosshairs is the U.S. shale industry.

John D. Rockefeller in the 19th century described this kind of battle as "good sweating"—low prices that put pressure on competitors. The term takes on added meaning now. The sweating in the market, as in a growing number of sick people, is a symptom of the new coronavirus.

The Coronavirus Roils Markets and Washington

00:00 / 24:14

SUBSCRIBE

The outlook for oil looked much better at the beginning of the year. The "phase one" U.S.-China trade deal appeared poised to boost the world economy and increase demand for petroleum. But the coronavirus epidemic and subsequent shutdowns in China caused demand to plummet in the world's largest importer of oil. Elsewhere demand has tapered.

The result has been an unprecedented shock to the global oil market. IHS Markit, where I work, estimates that in the first quarter of 2020 global demand cratered by 3.8 million barrels a day compared with the same period in 2019. This would be the largest drop ever, bigger even than during the 2008 financial crisis. Before Russia's decision on Friday, oil prices had already fallen almost 30% since the year began.

The Saudis, who cut oil output in 2019, were pushing the idea of further cuts out to the end of the year by the Organization of the Petroleum Exporting Countries and its non-OPEC allies as a way to stem the price decline caused by the virus. But on Friday Russian Energy Minister Alexander Novak delivered a clear message: Russia is not on board. Prices fell another 10%. On Monday Saudi Aramco announced it is slashing prices and boosting production, and the plummet followed.

The Russians provided a clue to their thinking on the virus by canceling the St. Petersburg International Economic Forum, the global conclave that is Vladimir Putin's answer to Davos. It was scheduled for June. The Russians see a global pandemic that will continue to bring oil prices down. A production cut would be a Band-Aid that would work only for a few weeks.

Consider also the relationship between Russia and Saudi Arabia. Mr. Putin's visit to Saudi Arabia last fall, during which he presented King Salman with a Siberian falcon, showed a growing relationship that extended beyond oil. But relations have since cooled, especially regarding oil. Moscow and Riyadh have different perspectives. Russia's budget relies on $42 a barrel. Saudi Arabia needs a considerably higher price, particularly to fund its ambitious Vision 2030 reform program.

The two countries have a fundamentally different view of the growth in U.S. shale oil production. Saudi Arabia has largely accommodated itself to the idea that American shale is here to stay. Not Russia. Moscow has asked why it should restrain its oil output and surrender market share to its strategic competitor, the U.S. Since the 2016 OPEC+ deal, U.S. oil output has grown by 4.8 million barrels a day—almost a 60% increase.

Russia may be an energy superpower, but it has been overtaken by America, which produces more oil and more gas—and considerably more oil than Saudi Arabia. The U.S. is also on the way to becoming one of the world's major exporters of natural gas, in its liquefied form. That provided another reason for Moscow to promote the "good sweating" to stem U.S. production.

The market disarray is also Moscow's payback for sanctions the U.S. imposed in December on the $11 billion Nord Stream 2 pipeline, which is meant to carry Russian natural gas under the Baltic Sea to Germany. The sanctions forced the barge laying the undersea pipe to stop work abruptly—a week or so short of completion.

One can surmise that Moscow interpreted the sanctions not as punishment for invading Ukraine or interfering in the 2016 U.S. presidential election, but as a way to favor U.S. natural gas exports to Europe. Support for that theory came from President Trump, who in a tweet last summer announced that Europe would be buying "vast amounts of LNG" from the U.S. He signed the sanctions bill a few months later. Moscow didn't think this was a coincidence.

Even if there is no deal for now, OPEC+ could be reactivated later in the year—or sooner if the pain becomes unbearable. As low-cost producers, both Saudi Arabia and Russia are well-positioned to duke it out for market share. Not so for other producers. In the past few years, U.S. shale companies have become more efficient and brought down costs. And growth in U.S. output was already on track to slow. Even so, shale is not low-cost and this good sweating will put pressure on U.S. producers. Companies will reduce or stop drilling. Some will go bankrupt or merge, and U.S. production will flatten out or, if prices stay down, decline.

For how long? That will depend on how long the virus continues to attack the health of the world economy.

Mr. Yergin is vice chairman of IHS Markit and author of "The New Map: Energy, Climate and the Clash of Nations," forthcoming this year.