Oil Industry Starts to Rebound, But Expect More Disruption

By Barry Samria

January 11, 2021

It is not an understatement to suggest that 2020 may have been one of the worst years in history for the Oil industry. We have seen record numbers of operators file for bankruptcy and historical debt levels that will continue to drive M&A activity as a survival strategy. The impact and effect of the global COVID-19 pandemic will have long and far-reaching consequences for the industry, with some commentators suggesting that the oil industry may never fully recover. What is worrisome is that while 2021 may not be worse than 2020, the year ahead is still likely to be disruptive for the industry. However, the disruption will not be felt equally amongst operators, as many have spent the past number of years working on becoming leaner, more efficient, and utilizing digitalization strategies that significantly lowered their cost base. Many challenges are still ahead, with the size of impact being up for debate; what is not up for debate is that hoping for the best is not a good strategy.

GLOBAL ECONOMY

The oil market thrives when the global economy is booming. We have probably seen the worst global recession in history driven by the COVID-19 pandemic, it was not surprising to see oil prices where they were in 2020 and the current recovery well underway. We need a thriving global economy to help boost the oil industry, the question remains when the expected recovery will again reach or exceed pre-pandemic activity levels. The case for Oil certainly not helped by the current reversal in easing lockdowns in many parts of Europe even as the vaccine is rolling out, nor is it helped by the considerably slower than anticipated roll-out of the COVID-19 vaccines. Given the sheer magnitude of vaccinating sufficient numbers of global citizens to get economies going again, we are unlikely to get anywhere near a state of "normal" (whatever that new normal looks like) until into 2022. As depressing as that may sound, it is a viewpoint supported by many leading economists.

On the positive side, many economists agree that global economies, particularly China, will grow very rapidly as we approach the pandemic's reverse side. Oil prices have recovered and continue to recover, boosted by the COVID-19 vaccines and several other recent events. The Saudis provided a boost for oil prices after the January 5-6 OPEX+ Members Meeting, releasing a statement that they are voluntarily cutting production by 1 million barrels per day for February and March; a much-needed booster after members had earlier agreed to increase output by 75,000 barrels per day. Another positive came in the shape of North American crude inventories' significant drawdown in December. All good news is welcome, but it isn't easy to read too much into that as it might be nothing more than the execution of year-end tax strategies.

CENTRAL BANKS TO THE RESCUE

If there is a ray of sunshine to be found in the current pandemic environment, look no further than the Central Banks' current fiscal policies, including the Fed Reserve. These policies of very low, almost 0% interest rates will, albeit temporarily, continue to support the substantial debt levels currently being carried by the U.S. Independents. They are further boosted by the Fed promising to keep rates at these low levels until inflation exceeds a 2% threshold. More support from the Fed is being driven through various asset purchase programs to inject liquidity into the financial system, with additional help on the way with the change in Administration. The breathing space generated through these policies is going to be crucial to a highly leveraged industry.

CHANGE OF POLITICAL ADMINISTRATION IN THE U.S.

Before the November presidential elections last year, there was considerable scaremongering from certain quarters about what a Biden presidency would mean for the oil industry. With talk of the Green Agenda, aggressive pursuit of Alternative Energy options, going back into the Paris Agreement on Climate Change, amongst many other supposed oncoming roadblocks for Oil. There is talk of bringing back elements of the environmental protections rolled back by the Trump Administration and the impact on drilling and leases on federal lands, particularly acute for the New Mexico portion of the Permian Basin.

These things are possible if not probable, but history has much to teach us on the timeline for the potential impact of the anticipated Green agenda and policies. We recommend putting aside much of the rhetoric about how the new Administration, especially now controlling all three government branches, will be bad for the oil industry. One only has to look back to the Obama Administration's tenure, policies not too dissimilar to what we hear now from the incoming Administration, and yet, oil production in the United States almost doubled during those years. The best thing that can happen for the oil industry now is to get the pandemic under control and provide additional stimulus to further boost the overall economy.

What is encouraging is seeing the new Administration going to great lengths to point out that its most significant priority is to control the pandemic and get the economy going again; this is precisely what the oil industry needs. The Energy sector finds itself saddled with substantial problems right now, but this robust industry will rebound strongly on the back of a growing pandemic-free U.S and global economies.

THE YEAR AHEAD

Even though we saw a vast improvement in the price of Oil in the second half of 2020, with many expecting a rosier picture still in the first half of 2021, there is much that organizations need to do to take advantage of upcoming opportunities.

In our next article, we will explore the role that oilfield digitalization will play in not only how oil companies come out of this downturn stronger but how they better shield themselves from future events, both major and minor. We strongly believe that oilfield digitalization will fundamentally change the operating frameworks for onshore operations and how organizations are structured.