ENERGY

Oilfield activity increases for 2023 despite fear of recession

The economy, geo-political tensions, and China growth worries have dominated the oil price narrative, with the growing fear of a deep global recession at the forefront. Despite the considerable number of current challenges for U.S. Operators, there is little doubt that U.S. Operators are in a substantially better position to weather any potential downturn in commodity prices.

Reference #2206

Oil prices have fallen to their lowest level since 25 January 2022, a month before the Russia/Ukraine conflict started.

Underlying factors are driving the continuing downward pressure on oil price, with a fear of a deep global recession at the very forefront. Many of the justifications behind the concern are well founded, including high-interest rates in both the U.S. and Europe, with another likely increase in Europe and the U.S. before the end of the year. Inflation continues its upward trajectory, perhaps not as fast as some economists have suggested, but rising nonetheless, impacting household spending, including travel.

Other factors continuing to create downward pressures on oil price include:

- Covid-related lockdowns in China, with the possibility of lockdowns continuing into 2023 and the economic impact on Chinese Tier 1 cities.
- Oil imports to China continue to fall, down 10% in August from a year earlier.
- Oil consumption in Europe continues to fall, exasperated by the halting of the Nord Stream 1 pipeline from Russia, adding further recessionary pressures.
- The potential for gas rationing in Europe during the peak demand winter season, causing likely partial shutdowns of factories.
- The U.S. dollar's strength is at record highs against the Euro and the British Pound.

Remarkably, this downward pressure continues despite OPEC+ missing their production target in July and August by a combined total of almost 6.5 million barrels. This is evidence that economic recession is dominating the oil price narrative.

Weaker economic growth and demand stagnation continue to offset tight oil supply, with the International Energy Agency predicting zero demand growth in Q4.

The current downward pressure on the oil price is a challenge for U.S. producers, but it is not all doom and gloom. There will be further supply restrictions into Europe as sanctions on Russia continue. In China, the world's largest importer, the economy is showing signs of recovery. The recent lifting of a total citywide Covid lockdown in Chengdu, a city of 21 million people, gives hope of China easing its stringent Covid policies. The Chinese economy is already starting to reap the benefits of the over $5 Trillion in stimulus the Chinese government is pumping into the economy to drive growth back to pre-pandemic levels.

Despite the considerable number of current challenges for U.S. Operators, there is little doubt that U.S. Operators are in a substantially better position to weather the next downturn in commodity prices.

U.S. independents are in a significantly better position today, operationally and financially, than in 2020, given the unheralded number of bankruptcies and Mergers & Acquisition activity seen post-covid. With the recovery in oil prices and near record highs seen shortly after the start of the Russia-Ukraine conflict, Operators have been busy paying down debt, rewarding shareholders, and restructuring capital. Most are now better positioned to take advantage of new growth opportunities.

M&A activity endures amongst independent operators, with considerable effort spent on debt restructuring and operating cost reduction. A significant focus to improve every facet of operations in the field and the office. Much of the operational improvements have focused on low-hanging fruit. For many, there is still considerable value to be had by taking advantage of more sophisticated digitalization-focused efforts and approaches.

Capital projects, including Drilling & Completion activity, have been on the back burner since the pandemic's start. Over the past two years, the Rig Count across the United States shows that Drilling & completion activity has slowed down drastically, twelve months ago, only 508 drilling rigs were active in the U.S.; even today, there are only 765 active drilling rigs.

It is easy to look on the bright side and suggest that we are almost 50% up from a year ago, but starting from such a low base, the percentage increase is not that meaningful, even today, it is only a fraction of what we saw during the Shale boom years.

Looking to 2023 and 2024, we anticipate that rig count will ramp up quickly as capital budget allocation swings once again in the direction of drilling and completion activity. This will need to happen given that the decline curve with new oil wells is significant in the first three years. Oil companies will have little choice but to ramp up D&C activity to protect total throughput and revenues. Our confidence in the ability of operators to quickly ramp up D&C activity is based on the total number of approved drilling permits sitting on the books of operators today. Nine thousand approved permits on federal lands alone, and more than half approved in 2021. It is difficult to estimate the total number of approved open permits accurately; suffice to say, enough approved permits to ramp up activity as rapidly as needed.

With oil prices likely to average $90 per barrel in 2023, operators should have plenty of confidence to start to ramp up oilfield activity. Our recommendation, as always, is to ensure a measured approach to activity ramp-up to deliver desired outcomes across any number of metrics, including safety, cost, and performance. Looking out to 2023/24, many of our clients are already quite advanced on the planning horizon to start new capital projects, especially drilling and completions activity.