Market Analysis

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Global Oil Markets in 2019-2020

Part III: Low Prices and Investor Pressure Forcing US Producers to Confront Tradeoffs

Key Takeaways

- The steep fall in WTI prices through the last quarter of 2018 dimmed production growth expectations for the US considerably from 2018's torrid entry-to-exit pace of nearly 2 MMb/d. The question is: by how much? Our base forecast sees US production growing at a still robust 1.2 MMb/d entry-to-exit on an annual average WTI price in the mid-fifties, down from $65/bbl in 2018, driven overwhelmingly by the Permian.
- However, the lesson of 2018 is that the US production system is highly sensitive and responsive to changes in capex, and higher oil prices transmit to more spending at the drill bit quickly. Understanding the dynamic is critically important, especially considering we expect 2019 to be another volatile year for prices.
- Our base case scenario sees a 6.5% increase in capital spending from $101.4 bn to ~$108 bn – which generates our call of 1.2 MM b/d (~12%) of entry-to-exit growth. Running upside (activity 15% above the base) and downside (activity 15% below base) sensitivity analyses helps to show two additional plausible outcomes for the year and illustrates the responsiveness of the system. These scenarios create a range of US production growth of more than 2.5 MMb/d, highlighting the starkly different paths for output that come with modestly differing reinvestment outlooks.
- The evolving "growth vs, capital discipline" debate is critical to understanding how oil prices will transmit to spending levels and ultimately production. Clearly, producers have moved toward living within cash flow and maintaining direct shareholder return policies in an attempt to resurrect equity market valuations. The days of debt-fueled growth appear to be waning, at least until the cycle turns further.
- To gain some insight into the consequences of this trend, we devised a model for the US onshore designed to show the consequences of the growth vs discipline tradeoffs for the US onshore as a whole at different prices. It showed:
  - **Maintenance:** In 2019, ~$48 WTI will generate enough cash to fund a capital program large enough to keep production flat.
  - **Freefall:** Sub-$45 oil prices can only be withstood for a few months or quarters before oil production starts to fall off rapidly.
  - **Tradeoffs:** Between $50/bbl and $55/bbl – roughly the current price – the onshore faces meaningful choices. It can either have growth of up to 10% or it can return cash to shareholders, but it cannot afford both.
  - **Surge:** As oil prices go over $55/bbl, strong growth becomes the norm, and above $65/bbl, we can expect another ~20% surge in output like was seen in 2018.

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