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PRESS RELEASE

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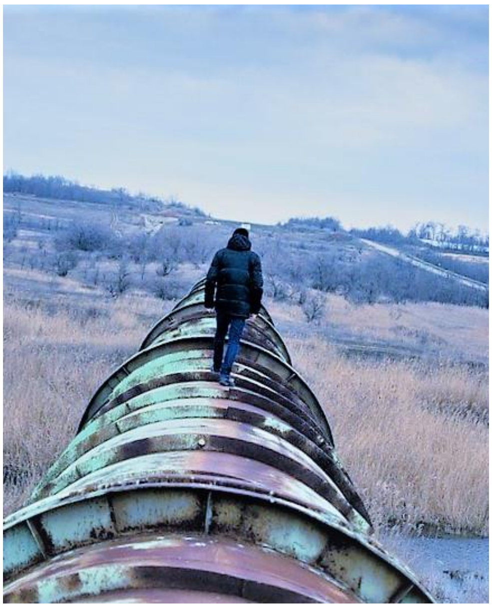
COVID-19 and the new elements of uncertainty



Expectations and new horizons for the oil and gas industry

The oil and gas industry was walking on thin ice even before the COVID-19 crisis hit the global economy. The industry was already struggling to find a new balance, battling with a flood of oversupply and a fair share of geopolitical instabilities. That brings up many questions, including: How and in what shape will the industry emerge from the crisis? Where are the prices heading? What effects can be expected for all stakeholders?

The impact that COVID-19 is having on the oil industry is already of historic proportions. In April 2020, Brent crude oil price crashed below 20 USD per barrel for the first time in 21 years. The dramatic free fall started to pick up pace in March 2020 fueled by a price war between Russia and Saudi Arabia and by the end of April the price lost almost 70% of its level at the beginning of the year. Fast forward to July 2020, the crude oil price had more than doubled in a gradual tight rope journey of recovery that started in May as the Chinese economy was emerging from the lockdown.

Further recovery could seem like a matter of time as the world gains more experience in battling the virus and the supply cut deal between OPEC and Russia that concluded the price war still stands. However, the COVID-19 crisis has only added additional elements of uncertainty to an industry already plagued with volatility and the course of recovery is still crammed with obstacles. The US Energy Information Administration - in their latest update to the short-term energy outlook - expects the Brent crude oil price to average USD 50 per barrel in 2021 after averaging USD 40 in 2020. Most of other price forecasts expect a similar recovery in the short run, while the long term prospects remain in limbo.

OPEC and Russia are set to start unwinding the supply cuts starting August 2020 adding 2 million barrels until the end of the year and another 1.9 million barrels between January 2021 and April 2022.
Another price war between Russia and Saudi Arabia in the short run seems unlikely as the Russian economy is reeling under the weight of COVID-19. The US oil production, which was believed to be a key driver behind the price war, is expected to continue dropping in 2021 averaging 11.6 M b/d in 2020 and 11.0 M b/d in 2021. In the US, the oil industry is under increased pressure as 23 exploration and production (E&P) companies and 15 oilfield service companies filed for bankruptcy protection in the first two quarters of 2020 with over USD 30 billion in debt.

Pressure on the crude oil price in the upcoming months is more likely to come from the demand side if a second wave of COVID-19 broke out of control especially in China; however, in this case the price of Brent crude oil will likely not go below the USD 30 per barrel limit.
As the prospect for the price recovery in the coming 2 years remains reservedly optimistic, the long-term picture is still far from clear. Some suggest that the oil industry could be heading into what is called a "super-cycle" that could bring a price as high as USD 190 a barrel in 2025. Under this scenario, the oversupply in the oil markets could turn into a fundamental supply deficit beginning in 2022 as the industry would face troubles to attract investments needed to rejuvenate the diminishing E&P activities.

As it is clear that E&P companies, especially in the US, together with the oilfield service companies are hit the hardest by the crisis, following question arises: Who would be cashing from the current downfall in prices?
Usually refiners benefit from falling crude oil prices as their margins get a boost. However, the current crisis, at least in the short to medium term, has also hit the demand for refined products giving refiners their share of hardships.
The picture in the midstream sector was mixed as the demand for storage shot up, while demand for pipeline transportation fell sharply. It is clear that the crisis did not spare the midstream sector, but it is in relatively better shape compared to its upstream and downstream counterparts.

Energy-intensive sectors such as manufacturing, which are usually sensitive to changes in the crude oil price, only received some relief as the COVID-19 crisis has already damaged their output.

Schlegel und Partner can help you navigate through the changing dynamics of the oil and gas industry by giving you an insight into possible future scenarios and what impact they would have on your business.

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