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Oil and Gas Industry Faces Uncertainty in the Face of Global Supply Changes and Policy Development

By Maribeth Hunsinger, J.D. Candidate 2019 | February 13, 2016

The global oil industry started to show signs of recovery in early 2017, as multinationals such as Royal Dutch Shell Plc and Exxon Mobil cut costs amidst rising oil prices to generate enough cash to pay dividends without borrowing. Following a wave of cost reductions and capital project deferrals, companies in the industry seem well placed to benefit from the Organization of Petroleum Exporting Countries' (OPEC) agreement to cut production in order to eliminate global oversupply and increase prices.

Saudi Arabia, OPEC's largest producer, led the reductions by cutting production by half a million barrels per day in January, and OPEC as a whole is now about 60 percent of the way toward attaining the desired production levels. OPEC and Russia combined have reduced output by at least 1.1 million barrels per day. However, slowing demand growth and increased production output from other countries have offset these efforts. Under the terms of the agreement, Iran, Nigeria, and Libya have actually increased production.

The U.S. has also started to increase production in response to the prospect of higher prices. According to ANZ Bank, "[t]he number of oil rigs in the U.S. [is] now at the highest level in 14 months, having risen over 20 percent since the OPEC production cut agreement was reached." This production increase is comprised predominantly of onshore drilling, with U.S. onshore drillers adding 267 rigs in the last eight months, according to Baker Hughes, Inc.

In addition to increased onshore drilling, some analysists have predicted that U.S. domestic oil and gas prices will fall as a result of Donald Trump's proposed "energy revolution." Trump's proposals range from a reform of the corporate tax code to a possible border tax, and while such measures would likely bring new investment to the U.S. oil and gas sector, the resultant output would also likely contribute to a decline in oil and gas prices. Many of Trump's policies have yet to be elaborated, so it may be too early to draw conclusions as to their potential impact.

In the face of uncertainties regarding U.S. domestic policy and ongoing changes to global supply, investors are understandably wary of the oil and gas sector. Energy stocks exhibited the largest sector decline in the S&P 500 last week, with oil dropping one-and-a-half percent. Prices have since steadied, with markets "torn between mixed price indicators." Since the beginning of the year, U.S. West Texas Intermediate crude futures and Brent crude futures, both key benchmarks, have remained within a five dollar per barrel price range.

The current lack of strong directional price indicators demonstrates the uncertainty that the oil and gas industry faces. As global supply reductions continue, and Trump's policies develop, it will be fascinating to see what impact the coming months have on industry players and investors.