Post 15th August, 2015

Happy Independence Day to all my friends on facebook! I was listening to PM Modi's speech on TV from the ramparts of the Red Fort a short while ago, and as usual he was quite impressive.

Onto the usual stuff:

My good friend John Logel, on reading my post last week, sent me the link below, which turned out to be a very interesting read. I suggest you read the article for sure.

http://www.telegraph.co.uk/finance/oilprices/11768136/Saudi-Arabia-may-go-broke-before-the-US-oil-industry-buckles.html

In my last post I had mentioned that all present indications are that the low oil prices are here to stay. Saudi Arabia has been pumping too much oil in the market and the glut has driven the prices really low. The author of the article on the link makes the case that Saudi Arabia will start running into trouble within the next two years. Some points that the authors lists in justification of this conclusion are as follows:

1. Low oil prices have led to cut backs in development drilling of the shale wells in the US. The wells that have been flowing oil are still there.
2. Yes, the low oil prices have killed some of the prospects that can be categorized as high-cost ventures, such as Russian Arctic, Gulf of Mexico, deep-water of mid-Atlantic and the Canadian oilsands. But the US shale fracing costs have come down and are dropping further. Pad drilling is used in these plays, which have driven the costs lower by say 50% and come down by another 30%.
3. The time to drill horizontal wells has been reduced to almost half.
4. Despite the drop in the number of rigs in the US, the oil production has risen and was 9.6 mb/d in June. It came down in July by close to 90,000 barrels, but looks like it won't drop appreciably.

Saudi Arabia, which relies on oil exports to the tune of 90% of its budget revenue, and has many financial outlets such as the war with Yemen, the military buildup that it is engaged in, etc., may not be able to sustain the low price process for long. Now whenever the oil price rises (it may be in 6 months or 1 year), the US shale oil output will also increase.

This suggests that whichever way it goes, Saudi Arabia will get into a situation whereby its foreign reserves will start shrinking very soon.

I found this article to be a very interesting read. You read it for yourself and find out.

Last week, someone had asked me about the break-even price of shale oil. As answer to that question, let me begin by saying that for conventional oil it varies. For Saudi Arabia, it is under $10 a barrel. For the Middle East and North Africa, it is about$20 a barrel, and at other places in the world, it is between $30 and $40 a barrel. Now shale oil costs more to produce, and also the cost of production varies because it depends on a number of factors. But the variation is between $40 to $70 a barrel. Another point to keep in mind is that while the conventional reservoirs can continue producing for years, shale reservoirs have a shorter production life. That is why more and more wells have to be drilled to keep up the production. But as I have written before, enhanced efficiency and technology are driving the prices lower.

As a digression, I may state that it is not only in the US, but the reduction in the cost of drilling new wells has come down elsewhere as well. Recently, in an article that I was reading on Vaca Muerta Shale in Argentina, after drilling many wells there, YPF, the national oil company of Argentina, has been able to reduce the cost per drill: in 2011, the cost per drill was $11M, $8.1M in 2013, $7.6M in 2014 and in the first quarter of 2015 it has come down to $7m. That gives you an idea about the cost reduction that has taken place in recent years, apart from the reduction in time that is taking place alongside.

Till next week, enjoy life!