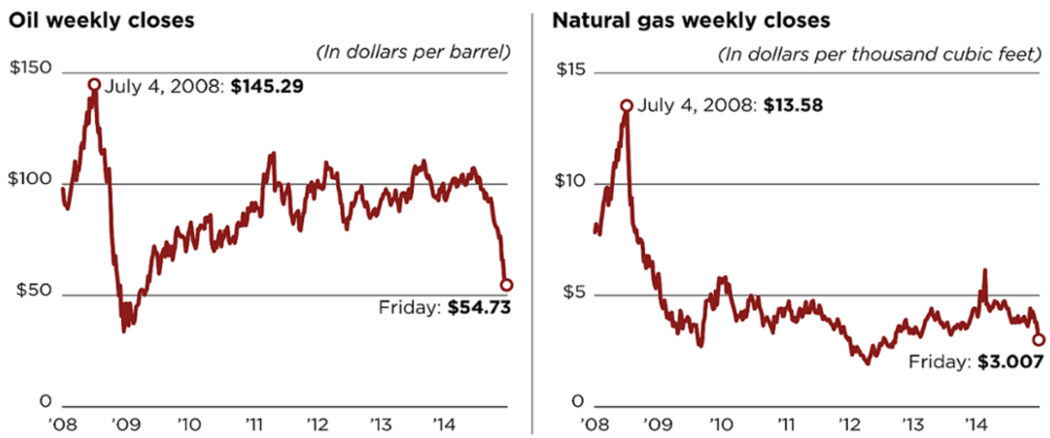
Cheryl Hall

Cheryl Hall: Is U.S. in an oil price nirvana?

Cheap oil and natural gas

The prices of West Texas Intermediate crude oil and natural gas plummeted during the recession as demand fell. This year, oil prices plunged again after OPEC didn't rein in production in late November. Natural gas has bumped along in a narrow price range, which experts say is likely to continue for at least four years.



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Dallas economist Bud Weinstein prays every night for $60 oil — give or take five bucks a barrel.

That's the sweet spot, he says, where the U.S. economy gets a boost without putting the brakes on oil-producing states such as Texas.

Lately, West Texas Intermediate crude has been fluctuating at the lower end of Weinstein's nirvana zone.

The price of oil has been cut nearly in half since June, punished by too much oil for a slowing world economy and piling on by speculators.

Oil prices tried to stabilize midweek, bolstered by indications of stronger demand from China and word that billionaire Harold Hamm, a kingpin in the North Dakota shale play, will scale back his company's growth plans next year. But the reprieve was temporary with West Texas Intermediate ending Friday at $54.73 a barrel, down another $1.79 for the week.

When oil is selling for $55 to $60 a barrel, drivers save about $100 per month per U.S. household compared with the peak, Weinstein says. America's manufacturers can make products cheaper, which makes them more competitive abroad.

"A strong case can be made that with oil in the $60 range, the pluses for the U.S. economy outweigh the negatives, even in the state of Texas," says Weinstein, the associate director of Southern Methodist University's Maguire Energy Institute.

U.S. prices are expected to average $63 a barrel in 2015, the U.S. Energy Information Administration says.

That's enough to make Weinstein do a happy dance. At that level, production in the nation's three major shale plays — including the Eagle Ford and the Permian Basin in Texas — would continue to grow, albeit at a slower pace, he says.

But what happens if the price moves much lower and stays there awhile?

"If prices fall to the $40 range, that's a different story," Weinstein says. "At that price, we do see significant retrenchment of the industry."

Texas and the 31 other oil-producing states aren't the only ones that will take a hit.

"Dirt-cheap oil isn't necessarily good for the Rust Belt," Weinstein says. "Steel mills along the Ohio River have come back to life in large part to supply components to the oil and gas industry in the Marcellus and the Utica."

Energy-independent?

The most significant consequence of the shale revolution has been overlooked, says Weinstein, who has been studying the Texas economy for four decades.

The U.S. now leads in production of oil, natural gas, nuclear power and renewable energy, and it's second in coal, he says. That means the country can no longer be held hostage by foreign energy suppliers.

"Every president since Jimmy Carter has said, 'We need to become energy-independent,'" Weinstein says. "Well, 40 years later, we are virtually energy-independent."

His boss, Bruce Bullock, director of Maguire, doesn't expect prices to bottom out for another couple of months, when demand typically hits the lowest point.

So how low will oil go?

"Anyone who answers that with any confidence is delusional," Bullock says. "The market is hypersensitive to the data du jour and day-to-day chatter from OPEC and industry experts."

Bullock's best guess is that West Texas Intermediate prices will bump around in the $50 to $60 zone before beginning to recover as the world economy stabilizes. Prices for West Texas Intermediate run in tandem with Brent crude oil but are about $4 cheaper because there's a glut of U.S. oil that can't be exported.

"The question is: How far and fast does oil come back up?" Bullock says. "There are a lot of moving parts that make that very difficult to predict. But the further it drops, the higher it's likely to rebound."

West Texas Intermediate hit its all-time high of $147.27 on July 11, 2008, just before the bottom dropped out of the U.S. economy.

But absent a major geopolitical event, you can forget about seeing that again anytime soon, Bullock says. "We're in a new world of $70 to $75 oil — certainly for the next few years."

That's because of one stunning change.

Price war

OPEC — the once-almighty consortium of oil-producing nations led by the Saudis — has abdicated price control power to producers in North Dakota and Texas, Weinstein says. "This is an astonishing development. If I'd predicted this five years ago, you would have rolled on the floor. It gives America huge economic and political leverage."

This new dynamic became apparent at OPEC's meeting in Vienna late last month, when the cartel didn't rein in production even a smidgen. That, in essence, declared a price war with the U.S. shale industry.

Prices went into a free fall and have struggled to find firm ground since then.

Bullock says the Saudis made a big mistake in thinking they could regain market share by letting prices fall. "OPEC has vastly underestimated the ability of the U.S. producer to adjust. By doing nothing, they have ceded their role as the swing producer in global markets."

The plunge has probably been better than "a slow bleed over the next year to year and a half, where we're going down a buck to a buck and a half a month," Bullock says. "At least we know the environment we're going to be dealing with. We can adjust capital expenditures appropriately and move on."

So far, smaller exploration and production companies have announced plans to scale back capital budgets by about a third for 2015, Bullock says.

Of the majors, ConocoPhillips Corp. and Apache Corp. won't spend as much on exploration and production as they originally budgeted, but they still plan to increase spending over 2014.

Other big players are likely to follow their lead, Bullock says.

Continental Resources Inc., Hamm's Oklahoma City-based company, is cutting expansion plans 41 percent for 2015. But that's still a year-over-year increase.

When industry capital spending plans are added together, Bullock says, production should be up slightly for the first half of 2015 and level off for the rest of the year. Demand should pick up in 2016, as should production.

"And the U.S. industry turns out to be pretty healthy," Bullock says. "But it's going to be a bit of a bumpy ride getting there."

David Biegler, chairman of Southcross Energy Partners LP, a natural gas master limited partnership, says his reconnaisance jibes with Bullock's predictions.

"We are hearing that production volumes of both oil and natural gas in the Eagle Ford in South Texas will continue to rise throughout 2015 and that additional midstream expansion [think pipelines, natural gas plants and natural gas liquids fractionation facilities] will still be necessary to get it to market," Biegler says. "We are planning for a continuing rise in production in South Texas but at a lower rate of increase."

Natural gas prices are going nowhere fast, says Biegler, former chief operating officer of TXU Corp., predicting that prices will continue to bump along in the low $3s per thousand cubic feet until winter demand boosts them to about $3.50.

Bullock agrees. "I don't see it getting much above $5 for the next four to five years except on a spot basis now and then when we get an Arctic cold snap. The good news is the industry has been very adept at cutting costs to cope with lower prices."

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