
How The Coronavirus Is Changing The World Energy Situation, And What It Means For Russia, The Middle East, And American Shale Producers

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The shockwaves to both worldwide civilization and the international economy of the coronavirus, COVID-19, continue to escalate, with energy being the latest front.

China, the world's largest oil importer, has drastically cut its demand due to the internal economic slowdown caused by the virus. This especially hurts Iran, for whom China was one of the last viable markets as a result of American international sanctions.

With international demand falling, OPEC held an emergency session last week trying to agree on a drastic short term production cut of up to 1.5 million barrels per day. Then on Friday, energy ministers from Saudi Arabia and Russia met in Vienna, with Saudi Arabia hoping to persuade Russia to make deep production cuts of its own. The talks failed. The price collapse that many oil producers feared looked about to happen.

Saudi Arabia decided to strike first. Its de facto ruler, Prince Mohammed Bin Salman, ordered an immediate surge in production to over 10 million barrels per day and offered deep discounts to potential customers, including Europeans who otherwise would have turned to Russia.

To quell any dissent, MBS initiated a crackdown on disagreement within his country, hoping to nip in the bud any internal dissatisfaction from the reduction in state revenue sure to come. With international demand plummeting due to virus fallout and intentional production now rising as both Russia and Saudi Arabia play a game of "oil chicken" to see who can withstand the price crash better, there now is no downward floor on oil prices. Just a few months ago, Russia and Saudi Arabia touted a new alliance as a major power force in the Middle East.

Now that agreement lies in tatters.

Clearly, both nations see the current crisis as a potential way to put American shale oil producers out of business. They've tried that before, however, and it hasn't worked. This time might be different, due to the precarious financial situation of many of the shale producers, but it would be unwise to take their vulnerability as a given. American shale producers have shown their cost-cutting ingenuity before, and may do so again. Many already are price-hedged through the end of 2020. Further, with the virus spreading and

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import restrictions coming to many countries, it is not a given that American consumers will find switching to foreign suppliers at this time of international trade uncertainty to be a wise move.

Ironically, the current turmoil actually may help northeast shale producers in the Marcellus region. Less oil production in Texas oil fields means less natural gas produced as an unintentional byproduct. That unintentional gas production actually has meant the marginal cost of each additional unit of natural gas produced has dropped below zero in some cases.

Potentially freed from that Texas production, the possibility exists that as oil prices plummet, natural gas prices in the northeast might stabilize. Thus, shale gas producers who are not overly dependent on also producing oil might have some cushion as Russia and Saudi Arabia fight it out.

Meanwhile in Iran, things are going from bad to worse.

The theocratic government was slow to isolate cities where the virus spread early, like the holy city of Qum. Pictures showed Shia Muslim Pilgrims kissing and licking holy shrines.

The government also was slow to isolate many already infected by COVID-19, including high government officials. At least two already have died, and some believe at least ten percent of Iranian lawmakers have been infected.

Last week the regime mobilized the army to try to stem the spread of coronavirus, possibly by cleaning streets or by enforcing travel blockades.

Distrust with Iranian state media is higher than ever. While officially as of the beginning of the week there were 6,566 reported cases of COVID-19 in Iran, few believe that is the true figure.

As faith in Iranian state media collapses, so too does Iran's economic situation. Already facing more-frequent protests by Iranian citizens over the government's foreign intervention, the Mullahs now have to turn increasingly inward just to stem the outbreak of the disease. That will be hard as due to the oil price collapse the amount of money Iran does receive from whatever oil it can sell will be much less than previously thought. Even if the regime survives, it may lack the financial strength to continue its foreign adventurism.

At this point, only two things are clear about the effects of COVID-19 on the Middle East and world energy. First, the Russia-Saudi Arabia rapprochement is on life support. What looked to be a potential major geo-political shift might instead prove to be the opposite, with the hardening of historical distrust between the two. Second, Iran's ruling Mullahs are facing a major decision point. If they decide they have no choice but to use all of their available resources at home, the implications will be serious for Hezbollah, Hamas, the Houti rebels and the other movements that count on Iran for financial and military support.

When an outside stimulus like COVID-19 hits, its impact can change the world. The fallout may take years to show, but the early impacts already are being felt.