THE FRACKING TIGER IS EATING THE RUSSIAN BEAR ALIVE

The US shale industry has become a hydra-headed monster for Russia – and OPEC too. Before they have contained one threat, fresh dangers keeps popping up in new and expanding zones.

This war of attrition in the crude markets is lasting far longer and biting deeper than the energy exporting states ever imagined. It profoundly alters the geo-strategic contours of energy, and the global balance of power.

The Saudis have conceded that the 1.8m barrels per day (b/d) production cut agreed by Russia and OPEC will almost certainly have to be extended when it expires in June. Stunned veterans fear that the global glut could drag on through 2017 and into a fourth year.

New technology is reviving old US fields already written off as largely exhausted, and in the latest twist the impetus is spreading to 'super-basins' in Latin America that threaten to replicate the US success story in short order.

"The tiger is out of the cage and it is going to be very hard to put it back in again," says Gerald Kepes, upstream chief for IHS Markit. "There are multiple basins that could really take off." Yes, out of the cage and eating the Russian bear alive.

The Baker Hughes rig count for US oil jumped by 14 to 631 last week. It has doubled since touching bottom in May 2016, even though the rally in crude prices stalled month ago.

The US has already boosted output by 660,000 b/d over the last nine months to 9.1m b/d, exactly where it was when the Saudis first began to flood the global market in bid to smash rivals and drive out low-cost producers in November 2014. The US energy department expects production to rise by another 109,000 b/d in April.

The US surge is led by the prolific Permian basin in West Texas where production held up through the slump and has since risen to 2.2m b/d. A report by Adriana Knatchbull-Hugessen at Citigroup said break-even costs have fallen to $30 a barrel in some core zones.

"Permian production looks poised to soar," she says.

Bottlenecks are beginning to emerge which could slow this. Rates for drilling crews are creeping up again. There is a bidding war for the high-grade proppant sand used in the fracking business - much of it 'northern white' from silica mines in Wisconsin.

Russia and OPEC have been betting that the shale industry's gains in cost efficiency from multi-pad drilling and longer lateral bores are partly a mirage, likely to vanish as the recovering cycle tightens the market for oil services. But there is evidence that frackers have taken more precautions to hold onto their edge this time.

"Even as well costs begin to inflate, we expect the Permian can continue to grow through to 2022 at only $50 a barrel," says the Citigroup study.

The bank estimates that oil output in the Permian could rise by another 3m b/d over the next five years even at today's depressed prices, competing toe-to-toe with the giant Ghawar field in Saudi Arabia. Total production of crude, gas and liquids in the Permian could reach 9.5m b/d if prices rise to $70.

What is ominous for both Russia and OPEC is that 'Permania' is spreading to other US fields. The Bakken in North Dakota and Montana suddenly has a new lease of life after dipping below 1m b/d. The expected collapse is not happening

Hess Corporation is tripling its rigs this year in the region. "We're back to growth in the Bakken. We're getting very attactive returns at current prices. The core of the Bakken is just as good real estate as the Permian," says founder John Hess.

Mr. Hess notes frackers can now target wells with 3D sesimic imaging and 'geo-steering' so accurately that recovery rates have risen threefold since the last cycle. "The technology is still in its early innings. We can drill a well in fifteen days. We've cut costs in half," he said at the IHS CERAWeek energy summit in Houston.

Harold Hamm from Continental says his group is ramping up operations in the area. "The Bakken has got great prospects. It still surprises everybody. We've got decades to do right there in the core," he said.

Mr. Hamm said the risk is that America's frackers may come back too fast for their own good. "We need to be careful not to overproduce. It has to be done in a measured way or else we'll kill the market," he said.

The old Eagle Ford basin in south-east Texas is also springing back to life. EOG Resources says costs have dropped so far that it can make 30% after-tax return at crude price of $40 with its latest wells. "It is truly historic. We are confident that we'll be one of the lowest cost producers in the global oil market," it has announced.

EOG has locked in service contracts at "bottom-of-the-market" rates for several years. Over the last twelve months it has cut the cost of drilling a well by $1m to $4.7m, a once unthinkable level. "There's still a tremendous amount of upward potential in the Eagle Ford," says EOG Production VP Billy Helms.

With variations, this is the story heard from shale producers across the US. It is why Exxon is turning away from global conquest and returning home, aiming to boost fracking to a fifth of its production. It has invested $6.6bn in Permian acreage.

Analysts had assumed that shale drilling would not spread easily beyond the US and Canada, due to skill clusters, abundant pipelines, and the legal structure of mineral rights. This is about to be tested.

Miguel Gutierrez, head of YPF, said his company has halved costs to $8m per well in Argentina's Vaca Muerta basin over the last two years. It has cut the time from 40 days to 15 days. Break-even levels have fallen below $40. "I'm sure that Vaca Muerta could be like the Permian," he said.

Shell is betting heavily on the Argentine field, part of its drive to master shale fracking after burning its fingers badly in the last boom. "We're getting pretty good at it. We have just drilled a 5km lateral well at Vaca Muerta for $5 million, and we drilled it from Calgary by remote steering," says chief executive Ben van Beurden.

An IHS Markit study of 24 onshore 'super-basins' around the world suggests that there are plenty more fields that could be revived along Permian lines using the latest technology, starting with the Tampico-Misantla fields in Mexico. These will take time to exploit but they are now indisputably part of the mid-term global equation.

The Saudi energy minister Khalid al-Falih, appeared shaken this month by his visit to Texas, where OPEC officials met privately with US frackers to gauge the force of the comeback. "We don't understand it. This is the place to learn," he said.

The International Energy Agency says the 40% collapse in oil and gas investment over the last two years will lead to a supply shock and much higher prices down the road. Natural decline rates of 3% to 4% are constantly eroding old wells. World demand is growing by 1.2m b/d.

But this crunch has been pushed out to the end of the decade by what the IEA calls the "second wave of the US shale oil glut". BP is battening down the hatches for even longer, planning for oil in a band of $55 to $60 for the next five years.

This is a very long time. The world faces a conundrum where shale can surge for several years but this in turn is inhibiting investment in conventional mega-projects, needed to meet the global 'base-load' demand in the long-term. Oil needs will be 100mn b/d by 2020.

If the shale bulls are right it means that Saudi Arabia and other OPEC states with costly welfare systems will have to continue burning through foreign exchange reserves to cover budget shortfalls for years.

For Russia it means having to finance pocket superpower ambitions and military overstretch with half the global income from hydro-carbons that the Kremlin was able to tap in the heyday of rearmament a decade ago. This analysis in The National Interest shows how Russia's military spending is in a state of collapse.

The shale story has become a global drama with massive geopolitical consequences.

Ambrose Evans-Pritchard is the International Business Editor of the London Telegraph.