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US Manufacturers Are Bracing For Impact Of Oil Price Plunge As Energy Companies Scale Back Crude Production

By Maria Gallucci - January 13, 2015

U.S. manufacturers are bracing for impact as plunging crude oil prices force energy producers to cancel or postpone new drilling projects. The slowdown in activity could spread beyond the energy sector, delivering a hit to steelmakers, local banks and construction firms, even as U.S. consumers benefit from lower energy bills.

“There’s a heightened sense of concern” among the makers of steel tubes, sheet metal, generator parts and other products that oil and gas companies use to produce fossil fuels, said Dan Davis, who runs a magazine in Illinois for the Fabricators & Manufacturers Association, a trade group. “Everybody is in a waiting game to see whether prices are going to bounce back.”

Oil prices have dropped more than 50 percent since mid-2014, spurred by the growing glut of crude supplies. While rising U.S. shale oil production helped drive down prices, many producers are now struggling to turn a profit under the current economic conditions. The number of working drilling rigs in the U.S. fell by 3.3 percent, to 1,750, rigs last Friday compared with the previous week’s total, according to a count by oilfield services company Baker Hughes Incorporated.

So far the largest U.S. industrial victim of crashing oil prices is United States Steel Corporation. The Pittsburgh company said last week it will lay off more than 750 workers at its plants in Lorain, Ohio, and Houston, Texas, citing tepid demand for its steel pipes and tubes used in oil and gas exploration and drilling. “The company has suddenly lost a great deal of business because of the recent downturn in the oil industry,” Tom McDermott, president of United Steelworkers local 1104 in Lorain said in a letter cited by the Wall Street Journal.

Analysts at Goldman Sachs forecast that global Brent crude and U.S. West Texas Intermediate could hover near $43 a barrel and $39 a barrel, respectively, in the first six months of 2015. Prices that low would sideline capital and curtail investment in new shale drilling projects well into the second half of the year, the bank said in a research note. Brent futures slipped 3.6 percent, to $45.74 per barrel, early Tuesday, while U.S. crude was down 2.95 percent, at $44.71 per barrel.

Many of the Fabricators & Manufacturers Association's 2,300 members have not yet felt the sting of lower oil prices, Davis said, since larger projects are planned and paid for weeks in advance of delivery. But he said companies that service oil and gas operators could see a drop-off in new orders within a matter of weeks or months unless prices rebound. "The potential is great, but currently it hasn't been calamitous," he said.

Chad Moutray, chief economist of the National Association of Manufacturers in Washington, D.C., said he expects some oil producers will delay making purchases in the next one to three months as they wait to see if oil prices balance out. "These prices have fallen very dramatically very quickly, and that has scared some folks," he said. "That's obviously a negative in that it adds a level of uncertainty to the marketplace that wouldn't be there otherwise."

Bankers in shale-rich Texas and North Dakota are feeling similarly wary about the pending decline in U.S. energy production. Banks in recent years have extended loans generously to the energy sector, enabling smaller operators to purchase drilling rigs, equipment and facilities and to pay workers' wages. But as prices erode profit margins and producers scale back, many of these borrowers could fall behind on payments, said **Bernard Baumohl, chief global economist at the Economic Outlook Grou**p in Princeton, New Jersey. "The smaller regional banks in Texas and North Dakota are suddenly going to find some of their loans are delinquent or not performing, and that can affect the earnings of those banks," he said.

"It's been a hot industry, probably a little too hot," Dick Evans, CEO of Cullen/Frost Bankers Incorporated of Texas, told the New York Times' DealBook blog. But he added, "[I]t is not time to panic. We have been in the game a long time. I am comfortable with what we have been doing."

The shale boom could also sour for realtors and builders in Texas and North Dakota, analysts say. Home prices have soared there in recent years as energy workers and their families set up shop. A recent report by Fitch Ratings estimated that Texas home prices are more than 10 percent overvalued and will likely decline due to falling oil prices. "Fundamentals do not appear supportive of current prices, and the economy is vulnerable to the energy sector," Fitch said in a December report.

In northern North Dakota, new housing projects have been shelved and local businesses shuttered as oil workers disappear from the scene. Timberline Construction Group said it put a 200-person “man camp” on hold last fall after an oil company pulled out of a housing contract, the Duluth News Tribune newspaper recently reported.

Despite the blow to certain industries, however, **Baumohl** said that the plummeting oil prices are a “net positive” for the rest of America. “While some sectors are going to experience hardship and see some real challenges, most of the U.S. economy will benefit,” he said. “Consumers will benefit because it means more money in their pockets, and for companies it just simply lowers production costs, and therefore increases their profit margins and encourages them to expand.”

Cheaper crude has pushed U.S. gasoline prices down to their lowest levels in six years. American drivers paid about $2.20 per gallon at the pump on average last week, the lowest price for this time of year since 2009, according to Lundberg Survey Inc. Americans saved around $14 billion on motor fuel in 2014 compared with 2013, according to AAA estimates, and could save as much as $75 billion more on gasoline in 2015. Analysts say those dollars will be pumped back into discount retail chains, restaurants and auto dealerships.

In the manufacturing sector, lower energy bills for businesses could help offset some of the lost activity from oil and gas suppliers, said the heads of manufacturing associations in Ohio and Indiana, two of the nation’s top industrial states. “It’s a mixed bag. Oilfield supply companies are hurt, but everybody else benefits from low energy costs,” Eric Burkland, president of the Ohio Manufacturers’ Association in Columbus, said. He pointed to the state’s auto manufacturing sector, which delivers $8 billion a year in gross state product and is poised to gain from the rise in new car sales. Thanks to cheap gas prices, sales of new cars are forecast to top 17 million this year, a level not reached since 2005, analysts say.

Patrick Kiely, president and chief executive of the Indiana Manufacturers Association, said that while some steelmakers and parts makers will see their energy sales decline, other Indiana industries such as chemical makers, pharmaceutical producers and carmakers will get a boost. “Indiana is a pretty diversified state, and we’re the most manufacturing-intensive state in the country,” he said. “We’re still trying to figure out the implications [of falling oil prices].”
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