HD **OPEC Buffeted by U.S. Shale Gale -- Barron's Asia**

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In the 1987 documentary Trader legendary hedge fund manager Paul Tudor Jones is seen aggressively shorting the equivalent of four tankers of **oil** ahead of a meeting of the Organization of Petroleum Exporting Countries at which a production cut was supposed to be agreed.

Having barked frantically at his broker over the speaker-phone to "do it, do it, do it!", Jones gives viewers a rare insight into his thinking on positioning **oil** trades ahead of meetings of the **oil** cartel.

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"My whole feeling is that anytime you try to get 13 people to agree to anything, and I have a chance to take a position on it, wild horses couldn't keep from betting against them succeeding in that."

The number of OPEC nations may have changed -- there are now 12 members -- but the advice seems as sage today as it did back in the 1980s.

As it did back then, OPEC members gathered at Thursday's meeting failed to deliver a production cut that would have stemmed the tsunami of **oil** flooding global markets. There had been very modest expectations the cartel's heavyweight producers -- Saudi Arabia and Kuwait -- may be prepared to show leadership by approving a group wide production cut in the wake of **oil** prices plumbing four-year lows. No deal! Rebuffing calls from Venezuela to cut production, the cartel decided to maintain its 30 **million** barrel a day production ceiling.

The response was unsurprisingly brutal. Brent **oil** prices tumbled close to 7% to a fresh four-year low of $72.58 a barrel. It was the biggest one-day percentage drop since May 2011. The best number to express the collective pain of **oil** producers across the globe is 50.3% -- that's the decline in the **oil** price since its peak of $146 a barrel in July 2008. That's gotta hurt.

Once feared as the setter of global **oil** prices, OPEC now risks looking like a paper tiger. The U.S. 'shale gale' has rocked the cartel's Viennese casbah, leaving OPEC looking defenseless against a supply onslaught from U.S. rivals assaulting their long-held dominance over global **oil** prices. Blame it on those fracking Americans! Fracking technology has encouraged an outbreak of drilling, with new wells peppering the U.S. as **energy** companies sought to cash in on the geological bounty offered by shale **oil** and 'wet' shale gas. Once an also-ran in the global **oil** game, the shale revolution has seen the U.S emerge, Lazarus-like, as a resurgent **energy** super-power with daily crude production of around nine **million** barrels a day.

The problem with revolutions is that they're bad news for those who hold the reins of power. OPEC is the ancien regime and the shale revolution has heralded the arrival of a new order. Well, that's the view of shale boosters like Citi's commodities team who earlier this month declared the rise of the U.S. as an **energy** superpower "is poised to usher in disruptive changes to global **oil** markets, trade and investment". Yeah, you don't say.

Not that OPEC is taking the new order lying down. The cartel is playing hardball with its decision to maintain production at full bore. The strategy is to keep prices low, squeeze the margins of upstart competitors, and ensure the cartel's share of the global **oil** market is maintained. Given much of the U.S. shale revolution has been built on a foundation of high **oil** prices and cheap debt, pulling out one of the pillars by driving **oil** prices lower may just be crazy enough to work.

But an OPEC 'victory' may be a Phyrric victory as lower oil prices will inflict collateral damage on the national budgets of those OPEC members who need high oil prices to underwrite government spending. Saudi Arabia and Kuwait, whose coffers are swollen by decades of wealth transfer from the oil guzzling West, have the fiscal muscle to ride out the real-time experiment in game theory. Who will blink first? OPEC may re-establish its street cred as the oil price setter if it can eviscerate some of the new competition, but it may come at the cost of eating its own.

The impact of lower oil prices are reverberating well beyond U.S. shale plays. At $80 a barrel, the aggregate cashflows of the world's 50 biggest oil and gas companies are 18% below 2013 capex levels, according to Bernstein Research. This is the first time this has occurred in 20 years. Common sense would suggest this isn't sustainable. But common sense seems in short supply in global commodity markets currently, as producers of oil, iron ore and thermal coal keep the pedal to the metal and seem intent on elbowing each other out of the way in the race to the bottom. It's market share or bust!

The bravado of oil producers may be causing self-inflicted wounds, but the carnage is being welcomed by energy importing nations. In Asia, lower oil prices are providing some relief to consumers, while also providing policymakers with additional flexibility to cut interest rates should the trajectory of growth start to turn down. The Reserve Bank of Australia, which holds its monthly board meeting next week, noted in the minutes from its last meeting that the "noticeable" fall in oil prices would support growth in energy importing countries.

China, the world's second largest oil consumer, is set to reap the benefits of lower oil prices. The North Asian giant revealed last week that it held 91 million barrels in its nascent development of a strategic petroleum reserve. While equal to a mere two weeks of oil imports, the world's second largest economy is expected to move quickly to exploit weak oil prices with additional purchases, as it looks to accumulate a crude inventory equal to 90 days of imports by 2020. While purchases by Beijing may provide some support to the oil market, China's black-box approach to decision making means investors will be left groping in the dark trying to divine the size and velocity of buying.

Not that the downward spiral of oil prices is all good news for Asia. Macquarie analysts this week argued that lower oil prices could be a poisoned chalice for Asia. Their rationale is that cheaper oil could encourage greater consumption, undermine attempts to increase energy efficiency and combat pollution.

There is no doubt Asian energy producers have become collateral damage from the showdown between the U.S. industry and OPEC. Lower oil prices are not great news for large Asian producers like China's CNOOC (0883.HK) and PetroChina (0857.HK). However, but Macquarie gives the nod to CNOOC based on its 16% return on equity, and the fact that forecast double digit production growth in 2015 should take some of the sting out of the weak price environment. The broker also calculates that PetroChina should be able to generate a positive free cash flow yield -- or free cash flow divided by the share price -- even if oil prices fall to $50 a barrel. Bernstein argues that PetroChina and Sinopec would be loss making at $70 a barrel.

Their pain is also likely to be felt Down Under, with the economics of Australia's massive expansion into liquefied natural gas coming under question in the new oil price environment. Australia is set to emerge as the world's biggest LNG producer by the end of the decade, but project backers have been caught in a pincer move between falling oil prices -- which are used to benchmark long term contracts with Asian customers -- and the rise of rival gas supplies from the U.S. Origin Energy (ORG.AU) was down more than 6% in early afternoon trading in Sydney on Friday, while Santos (STO.AU) had been hammered nearly 10% lower. Both companies are backing LNG projects in Queensland that use coal seam gas, but which have been dogged by cost fears.

While the long term demand for LNG is expected to be robust, Bernstein favors LNG exposed plays like Australia's Oil Search (OSH.AU) which has LNG operations in Papua New Guinea, and Japan's Inpex (1605.JP) which is building a LNG project in Australia's Northern Territory. Bernstein raised its target price on Inpex earlier this week, arguing there may be 40% upside for the stock as the risks from the Ichthys project recede.

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