Impact of a low oil price environment on supply, demand, stability & growth

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The current down cycle is unusually deep and long – although this is not unprecedented: Key questions are what to make out of the last decade of high prices (one-off anomaly vs. new norm?) as well as the industry losing out on ca $7billion on a daily basis compared to the period 2011-14.
Supply

The question is how many of the marginal resources will be required going forward. Lower break-even costs are only one factor in the equation – the other is higher supplies from low-cost producers (OPEC & Russia). Equilibrium is also very sensitive to demand movements.

This is a snapshot of volumes supplied / demanded on an annualised basis. Short term outages as well as future developments are not reflected. Production costs (full cycle costs in this case) are only indicative as there are huge variations within each category.

Source: JBC Energy
For the long-term supply outlook it will be crucial to what extent lower spending will be counterbalanced by lower costs.

(*ExxonMobil, BP, Shell, Total, Conco, Chevron)
The lower prices go and the longer they stay lower, the more pronounced will be the North American production slump. We could also imagine y-o-y declines to reach a level of 1.5 million b/d in H2, with a significant impact on the balance. Generally speaking America hosts a lot of high-cost output.
Supply

Efficiency gains and cost cutting measures could lower break even prices even further, which could spark a quick shale recovery. Also, higher prices (50-60 $/bbl range) could lead to a ramp up. However in longer term growth will become slower and will not compensate future shortfalls of conventional production.
Demand

Oil consumer prices have fallen only by a fraction of the oil price fall, limiting price and income effects. The Middle East has even seen rising retail prices as governments curtail subsidies to counterbalance lower oil income.

Price Changes since January 1st, 2014 [%]

- Price changes were calculated using local currencies.
- *Middle East data is an average of retail price changes in Saudi Arabia, Kuwait, Bahrain, Oman, and the UAE.

Sources: ICE, Various

Oil consumer prices have fallen only by a fraction of the oil price fall, limiting price and income effects. The Middle East has even seen rising retail prices as governments curtail subsidies to counterbalance lower oil income.
Overall, we do not see oil demand much higher than before the price fall, but gasoline demand is now cumulatively 1.4 million b/d higher, while gas oil/diesel demand is 0.3 million b/d lower than assessed in early 2014. “Peak demand” is an issue – and limiting the upside for oil prices.
Refining

We assess global spare refining capacity to have tightened further in 2015 in line with strong demand, among other factors. We do not expect a reversal of this trend in 2016. CDU shutdowns of 6.8 million b/d in 2009-2015 have provided key support.

Tuesday, 16 February 2016
Refining

Annual CDU Capacity Increase vs Demand Growth [’000 b/d]

CDU capacity additions are struggling to meet demand growth over the current years. Delays and cancellation of projects have tightened the refining market. Low oil prices lead to further investment cuts, while China and India are in a low-investment cycle.
After an unprecedented 10 quarterly stock builds, the market will **start** to tighten in H2 2016. But we now see a lengthening of the balance again in H1 2017, before things **begin** to improve on a more constant basis.
Talking Points

• Peaking Supply Growth?
  – CAPEX by big six IOCs has peaked in 2013, while production levels fall since 2010
  – Question of how much costs fall compared to spending cuts
  – Shale oil will not save us from a potential shortfall in traditional supplies in case of persistent underinvestment

• Peaking Demand Growth?
  – Low oil prices will fail to provide much demand stimulus in the medium to long term
    • Other energy prices are also low
    • Green revolution, substitution & efficiency improvements move ahead
  – besides strong upward revisions for 2015, going forward we don’t see oil demand much higher than before
  – exception: gasoline (cumulatively +1.4 mbpd), while gas oil/diesel -0.3 mbpd compared to 2014

• Peaking Refining Spare Capacity?
  – Investment cuts do not only affect oil & gas upstream. (National) Oil Companies in cash strains do also cut back investments in refining, petchem, LNG & other mid- and downstream segments
    → Refining sector will maintain reasonably healthy margins

• Oil market balance is de facto unpredictable for the coming years?
  – Clearly current information favours surplus to continue well into 2017
  – But geopolitical risk, potential OPEC policy changes and turning supply-side dynamics in high-cost areas can easily change the balance upside down amid historically low spare capacity levels
Thank you!

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