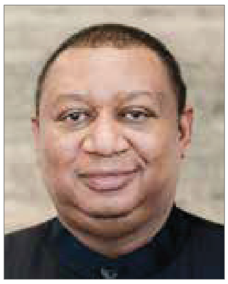
Keeping a close eye on all timeframes in the oil market



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The past two years or so have seen the global oil market go through a significant period of readjustment. Crude oil prices have fallen significantly, many investments have been deferred and some cancelled, manpower has been laid off, supply has been greater than demand, stocks have risen above their five-year average, and the market has been searching for balance.

This year the market has showed some signs that supply and demand are on course to align, although inventories remain a significant concern. Since the end of 2013, the five-year average for OECD commercial stocks has risen from a negative level of 85 million barrels to a surplus of around 340 million barrels towards the end of the third quarter 2016. There is no doubt that this development has strongly impacted crude prices, and continues to impact them today. Moreover, for the same period there has also been a rise in non-OECD inventories, plus an expansion in some non-OECD strategic petroleum reserves.

It is vital the issue of the stock overhang is addressed to restore balance to the market. In order to accelerate the ongoing drawdown of the stock overhang and bring the rebalancing forward, the OPEC Conference decided on September 28, 2016, at an Extraordinary Meeting held in Algiers, to opt for a new OPEC-14 production target. OPEC is committed to evolving a 'sustainable stability' to the market.

It should be stressed, however, that given that non-OPEC supply increased by over 5 million barrels a day (mb/d) between 2013 and 2015, compared to OPEC keeping supply fairly stable over this period, it should be viewed as something that all major producers look to tackle together. We have heard encouraging statements and have had consultations with some non-OPEC producers, such as the Russian Federation.

There is no doubt that the industry will recover; this has been another cycle, albeit an extremely challenging one, in the industry's history. It has bounced back from others, and it will emerge revitalised from this one.

Of course, it is essential to maintain focus on the near-term, but it is also crucial to recognise how this cycle could affect the medium- and long-term outlook, and understand the potential impact of other challenges facing the industry.

In this regard, two key issues will be underscored in this article: investments, and climate change.

Investment requirements

In the current depressed price environment, a major medium- and longer-term issue relates to investment. In looking ahead, it is clear the world desires more oil, and this means more investment. OPEC sees oil demand increasing by 16.4 mb/d between 2015 and 2040 to reach 109.4 mb/d, with non-OECD countries leading the way.

This demand growth is driven by developing countries, as they continue to industrialise, develop their infrastructure, and as billions look to have access to modern energy services for the first time. In terms of oil-related investment requirements, these are estimated to be around US$10 trillion over the period to 2040. These are huge investments that need to be made.

However, the present situation is putting this future at risk. We are currently witnessing a dramatic drop-off in oil industry investments. For example, global exploration and production spending fell by around 26 per cent in 2015, and a further 22 per cent drop is anticipated this year. Combined, this equates to above US$300 billion.

It is vital to keep in mind the link between the marginal cost, the price and investments. It leads to the question: Are current prices at a level that will see all the necessary future investments take place? We also need to keep in mind that new barrels are needed not only to increase production, but to accommodate for decline rates from existing fields.

The upshot is that if the necessary new capacity does not come online in the coming years, the market could move from one of too much supply, to one of not enough. It is important to remember that the previous high oil-price cycle was the outcome of a lack of investment in more supply. And the low oil-price environment of today is the result of too much investment in high-cost production during that period.

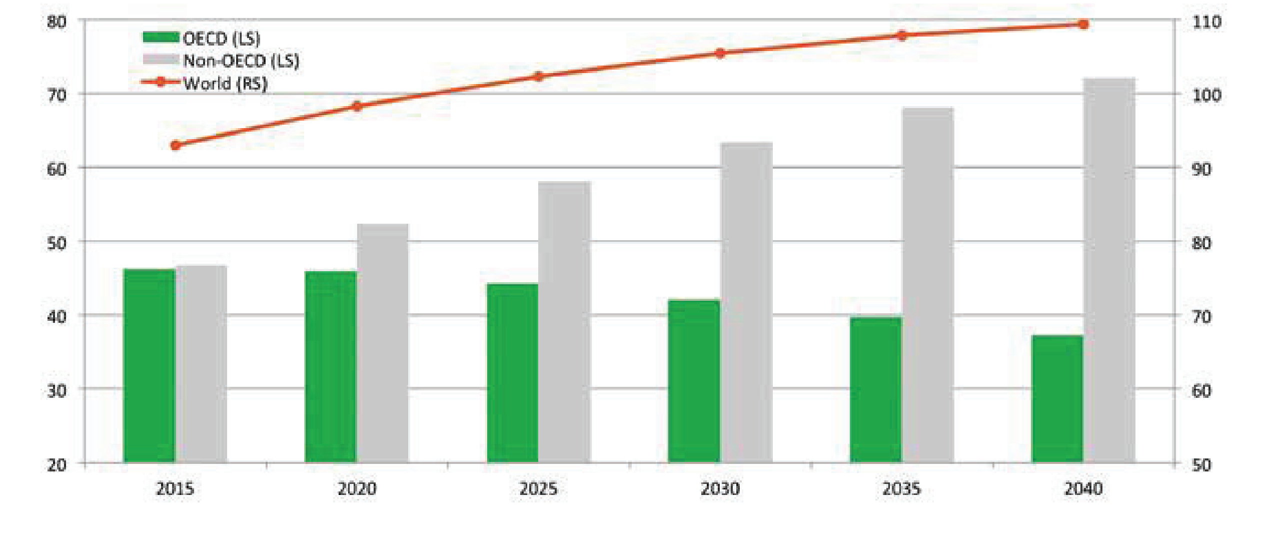
Sustainable development

Alongside the requirement for more oil in the decades ahead, there is also the need for more from all energy sources. Energy demand is set to increase by close to 40 per cent between 2015 and 2040, as the global population expands and economies grow, and as billions seek access to modern energy services.

At the same time, however, alongside these economic and social challenges, it is vital to place environmental challenges, specifically climate change and the need to reduce emissions.

For the global energy industry, the basic challenge is twofold: To supply enough energy to meet demand and help provide access to modern energy services for all. And to

Global oil demand outlook (2015-2040) mb/d



ensure that this is done in a sustainable way, which balances the needs of people in relation to their social welfare, the economy and the environment.

In OPEC's outlook, oil and gas are anticipated to continue to supply more than 50 per cent of the global energy demand by 2040. Of course, this is only one outlook. Other forecasts will no doubt be different. But it is important to recognise that there has not been any major outlook predicting that non-fossil fuels will overtake oil and gas in the decades ahead.

The energy mix cannot be changed overnight. This will take many decades. Yes, we need to continue to push the development of renewables, and many of OPEC's member countries are making great strides in this regard. However, we also need to appreciate that oil and gas will continue to be a major part of the future.

For oil, the products derived from this precious natural resource are fundamental to our daily lives. It is not just about transportation, but a whole host of everyday products.

Of course, there are environmental issues regarding the emissions that come from fossil fuels. But given their continued importance to individuals, business and the global economy, we should look at ways and means to overcome this challenge.

OPEC welcomes the COP21 Paris agreement, and in this regard, believes that we need to look to human ingenuity to not only advance energy efficiency and help deliver renewables and the technologies that allow them to develop at a greater scale, but also to find solutions in technologies for fossil fuels that reduce and ultimately eliminate emissions.

Our global energy future and the challenges the industry faces need to be viewed over all time horizons; the short-, medium- and long-term are all interlinked. What is clear is that over all timeframes we will need more energy and a stable platform for the necessary investments to take place. It means looking at all the various energy options available, appreciating just what each of them can provide to a growing global population in the coming decades, and taking into account a variety of inter-related issues concerning social welfare, economics and the environment.

We need to be realistic about our energy future. And ensure that all the possible energy options and technologies are explored, developed and utilised. Of course, none of us can plot the exact path of our energy future, but the shared objective must be a stable and sustainable energy future for all.