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26th OIES Brainstorming Meeting

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On May 7-8, the Oxford Institute for Energy Studies held the 26th OIES brainstorming meeting in Athens, where more than 30 energy experts and industry officials from Europe, the United States, the Middle East, Russia and other regions had vigorous discussions on a wide range of topics from the world economy and geopolitical risks to the oil market, the gas/LNG market and environmental problems. In the following, I would like to review key points that caught my attention at the meeting.

The biggest focus of attention at this year's OIES brainstorming meeting was how the impact of the recent crude oil price plunge on the international energy situation should be analysed. Last year's OIES meeting took place in June when crude oil prices were spiking due to the emerging ISIS (Islamic State of Iraq and Syria) problem. For details, see my 175th special “A Japanese Perspective on the International Energy Landscape” bulletin. Despite various uncertainties, a dominant view at the 2014 meeting was that crude oil prices would remain high. In fact, however, prices soon began to decline. Toward the end of last year, crude oil prices accelerated their free fall. In January, the benchmark West Texas Intermediate futures price plunged to around $45 per barrel, losing more than 50% from the peak. Oil prices have recently rallied on growing signs of a decline in U.S. oil output. The WTI price rose back above $60/barrel, making the oil price recovery or hike a matter of concern in the market again. Basically, however, oil prices have been far lower than in the previous year. The low oil prices were thus the focus or undercurrent of discussions at the brainstorming meeting.

As usual, the OIES meeting began with discussions on global economic problems and geopolitical risks, where the low crude oil prices were a key issue as well. In the world economy, the United States is serving as a single engine to drive global growth, with emerging economies losing steam. But a sense of caution has arisen about the future course of the U.S. economy, as indicated by recent wild stock market fluctuations. Downside risks also exist for the "new normal" Chinese economy, though with no major economic collapse anticipated. In Europe, whether the Greek debt issue would lead to Greece's "Grexit" exit from the euro zone and how the exit would affect the European economy and the world have become major matters of concern. While uncertainties are lingering about the world economy, many participants in the OIES meeting noted that crude oil price falls are playing a role in stimulating economies including major oil consuming countries and that they should find out the effects of the low oil prices. As for Russia that has been affected most by the oil price plunge among oil producing countries, OIES meeting participants pointed out that the economic downturn, though severe, is less serious than that in the 1990s and that any economic collapse has been avoided as the ruble's depreciation has eased the impact of a decline in oil sector investment for example.

As for geopolitical risks, OIES meeting participants took up various topics, including Libya, Syria, Iraq, Yemen, Iran and other Middle East problems, and the Russia-Ukraine problem, as seen last year. These problems remain so complicated that it is difficult to find solutions. But some participants noted that these geopolitical risks have made no major contributions to oil or gas supply cuts so far with some notable exceptions. One called for paying attention to a point that Libyan and Iranian supply has hit bottom and could increase depending on future developments (including the conclusion of Iran's nuclear negotiations with P5+1).

Based on these conditions, OIES meeting participants presented interesting arguments about how the oil price plunge has altered the international oil market and how oil prices would move in the future. The low prices caused various reactions from both the supply and demand sides. Many participants pointed out that the low prices have brought about various changes to the supply-demand balance by stimulating oil demand partly backed by an effect to pickup economy and leading high-cost oil production to be reduced or restricted. While one participant noted that the low prices have affected shale oil production and deepwater oil development, another pointed out we should understand that effects would be exerted on shale oil production over a short cycle and on deepwater oil development over a medium to long cycle.

The above means that shale oil production will gradually slacken and decline as an oil price plunge immediately causes a decrease in rig operations. If crude oil prices rise beyond $60/barrel, however, shale oil production may increase fairly quickly with recovery seen in investment (including spending on shale oil wells that have been dug while not yet having been completed). For deepwater oil development, investment costs per project are far greater with longer lead times. The impact of a delay in investment in deepwater oil development under the current oil price plunge will affect the market over a medium and longer term.

In the presence of the two cycles, the market could require crude oil prices to rise back to $70-80/barrel over a medium term to stimulate investment and a substantial production expansion to meet future global demand growth and offset a natural output fall at existing oilfields, according to a view given at the meeting. But other participants noted that short-cycle changes in shale oil output could work to hold down price hikes. Given high-level oil inventories and oversupply, and downside risks for the immediate future, however, the oil market is still plagued with great uncertainties. Discussions at the meeting led me to believe that it is premature to interpret the recent price recovery as signaling any full-blown hike.

As for Saudi Arabia's oil production policy that attracted attention from market participants by playing a great role in leading oil prices to plunge since the second half of last year, a participant pointed out that the oil kingdom now gives top priority to maintaining its market share under a long-term strategy and has set its new oil production norm at more than 10 million barrels per day. But another view noted that Saudi Arabia's policy should be understood as free from any ideology and changing in response to market conditions. Given Saudi Arabia's great influence, we may have to keep close watch on the recent realignment of oil policy-related organizations, policy personnel decisions, high-level officials' statements on the oil market and their impacts.

Lastly, interesting arguments came about gas and LNG market problems under the new environment of falling oil prices. Particularly on the Asian LNG market, one participant in the OIES meeting pointed out that LNG prices for long-term contracts are falling in line with spot price drops and low crude oil prices as the supply-demand balance is expected to remain loose due to slack demand growth and a substantial increase in supply from Australia and the United States over the next four to five years. It was also noted that LNG price falls can stimulate LNG demand and cut LNG supply expansion over a medium cycle, working to tighten the supply-demand balance over a medium to long term. Furthermore, there are various uncertain factors including possible U.S. LNG exports to Europe and Russia's strategy to take advantage of its surplus capacity for countering such U.S. exports. Under the new market environment, we may have to continue watching the abovementioned developments.

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