OIL MARKET ANALYSIS

*(EXPORTING COUNTRIES SUMMIT **17 APRIL '16**)*

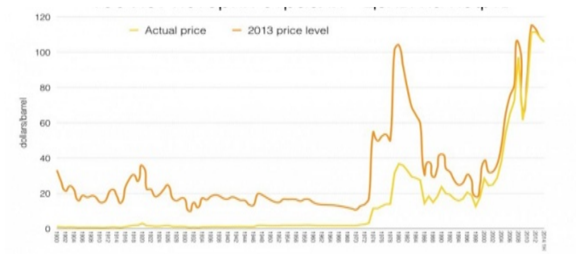
I would like to analyze the meeting in Qatar that was held this weekend, from the perspective of the consideration the main factors that influenced oil drop and plays key role so far.

History of oil prices

Such deep changes, when the price hit a few consecutive psychologically important levels (this time 80$, 60$ and 50$), occur periodically – for the past 100 years the oil industry has suffered at least 7 serious adjustments to the downside of the scale (% drop from the peak price) comparable with what we see in the years 2014 – 2016:

Source: data of Reuters agency & medium.com

And it can be concluded that the strength and tenderness of last fall that we see, is natural, despite that oil prices dropped sharply (to 30$ in January), it still costs more than the average price of a long term - from 1981 to today the average cost of a barrel of oil is around 34$. However specific factor is that never before in entire history of the level of oil prices, was as overvalued as from 2011 – 2014 (in July 2014 it reached 115$):



Source: data of Reuters agency & medium.com

Reserves, Production

Strong political aspect: a large proportion of state owned companies that dominate oil production – Saudi Arabia, Iran, Brazil, Venezuela, Russia and other countries, where the state share of the oil is 100% or at least substantially above 50%. Apart from state owned companies, any other major oil company is in very close contact with the government.

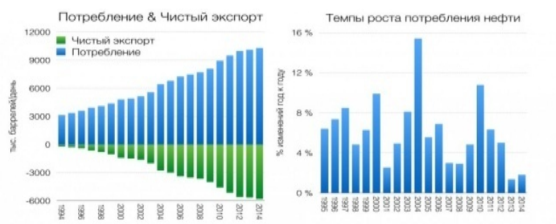
So to limit the production, which was the main reason of summit in Doha, for the most of the producing field is unprofitable: the process of limitations itself, as well as the maintenance in operational conditional settings and further recovery of production, is very expensive; large share becomes unrecoverable; investments "stand".

Currently, the world production is 1.5 mln. barrels per day (BPD) more than consumption:

Source: Thomson Reuters Eikon

Demand of China

Demand for oil in China (the flagship of the Asian region and the second largest importer of the oil in the world) for 20 years, rarely falling below 4% for the year and some of the years reaching growth of almost 15%. But last couple of years, rate in China is not so high because of the "surge" of the economy (2015 finished with the worst in a quarter – century of GDP 6.9%) and apart from that superimposed aggravation of environmental problems.



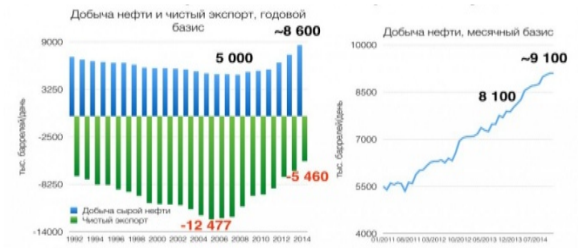
Source: data of Reuters agency & medium.com

Almost in all developed countries these processes gives zero or even negative growth: encouraging decrease in consumption of petroleum products and crude oil, transition to cheaper gas and coal for electricity production, the rapid development of renewable energy sources, reduction of displacement of hybrid engines in the new cars.

Regarding global demand, the IEA (International Energy Association) has lowered the March oil demand forecast for global growth in year 2016 to 1.16 mln. BPD (previous forecast 1.25 mln. BPD).

Shale development in the USA

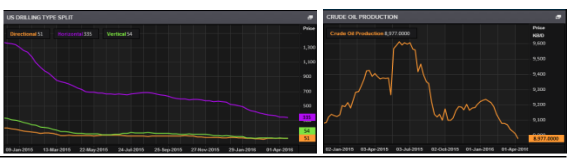
If 10 years ago the cost of oil shale production was 150$ with the oil price at 40$, then in 2012 reducing the cost to 60$ - 80$ with oil price at 90$ - 100$, innovative developments "rushed". During 3 years in 2012 in state of Dakota shale oil extraction was increased 10 times. Along with the increase of USA oil production, oil consumption started to decrease so imports fell even more. With the peak of net imports in 12.5k BPD in 2005, the "leader" of world consumption in 2014 will buy on the side just 5.5k BPD:



Source: data of Reuters agency & medium.com

Last Wednesday were released data about more than expected increase of USA crude oil reserves: according to US Energy Information Administration, on 6.6 mln. during last week (analysts expected only Δ=1.85 million); total amount of reserves reached 536.5 mln. barrels.

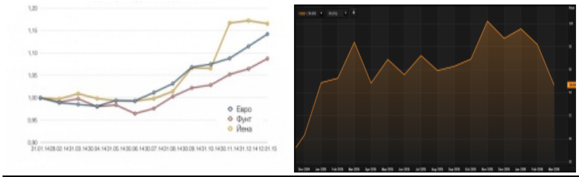
Extraction of shale oil decreased only 9 months after prices had started to fall in June 2014; current (February'2016) is 5 mln. BPD with new cost of production now at $50 (decline 35% since 2011). If oil prices remain at the level below 40$, then according to the forecast of IEA's, at the end of 2016 the production will fall to 4.5 mln. barrels:



Source: Thomson Reuters Eikon

Strong Dollar

US Dollar still has an impact on oil quotes even if not as strong as before. Since 2015 USD Index demonstrates a serious strengthening:



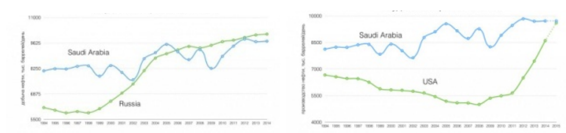
Source: Thomson Reuters Eikon

For sure prices are adjusted by scale denominated in $, it enhances the dynamics of the fall.

Attitude of Saudi Arabia

Loomed after 50 years of "solidarity" discord in OPEC (42% of world production) plays into the hands of Saudi Arabia, which accounts for almost 1/3 part of total OPEC production. Saudi Arabia has the biggest reserves, including high quality "light" oil, low costs and large production control capabilities – increase and reduction.

Saudi Arabia "plays" ("no" by SA means "no" by the whole OPEC) first of all against producers of non-traditional oil in USA and against the Iran's share of market (more about that further), cause the cost of production of already developed fields (for ex, in Russia only 40$) and extraction is unprofitable to reduce, even working "to zero". But Russia has increased production to the maximum (January level of 10.91 mln. BPD was the highest over the past 30 years), and Saudi Arabia does not use its unique position and does not increase production, even though, according to Reuters, can increase the capacity from 10 mln. BPD to 11.5 mln. immediately and to 12.5 mln. in 6 – 9 months:



Source: data of Reuters agency & medium.com

But existence of a high level of foreign exchange reserves ($582 bln. in February'2016) allows Saudi Arabia, even in the case of deficit budget and necessity to suspend or curtail construction or infrastructure projects (what Ar – Riyadh is ready for) to win "in long-term" and to put further pressure on prices until 2020.

Ambitions of Iran

After lifting of sanctions on Iran, it doesn't intend to join Doha agreement, until the country increases production to 4 mln. BPD from February's 3.29 mln., that was already maximum over the past 2 years; it is expected the similar increase in 2017 to 4.5 mln. Recent Tehran's activities are also aimed to take maximum situational advantages: contract to increase supplies to Europe to 700k BPD from 500-600k before sanctions.

Regarding more risky projects, effect from which won't be felt more soon than 2020: negotiations with Turkey as its energy security guarantor and the full satisfaction of its needs in oil and gas; Iran has an interest in Indian refining sector and tandem with the Indian Company ONGC Videsh on newfound Iranian field "Farzad-B". In addition the Foreign Ministries of Iran and India agreed on the contract of Chabahar Port and a loan of $150 million from India, as well they discussed the project of transport corridor "North – South".

Indian partnership will be continued at the next meeting in Moscow of the foreign ministers of RIC (Russia – India – China) where was invited also Iran – to remember: because of influence on Tehran, Russia had strong positions in meeting in Qatar.

Meeting in Doha results

From OPEC, apart from Iran, Libya as well did not took part in summit cause it's going to increase production again – 4 times more up to 1.16 mln. BPDs, like before the fall of the former Gaddafi regime and outbreak of hostilities. For the first time in past 15 years unexpectedly "tough" position of Ar – Riyadh, that agreement will not be without connection of all exporting countries to the decision to "freeze", obviously concerns to Iran and bit less to Iraq (monthly production volume increases by 32% since June'2014). Although, to be fair, Norway didn't also participate in the meeting (the biggest oil exporter in Western Europe - last year its production had increased by 4%, to 1.56 mln. BPD), as well as Canada and USA.

For today the average imbalance of oil supply and demand in 2016 is expected to be about 0.64-1.1 mln. BPD. This case is to become on the condition that OPEC members will stop to violate quota 32.3–32.5 mln. established by cartel itself (before Indonesia returned to organization, it was 30 mln. BPD). Among the victims are those who have no possibility to "increase" volumes: Ecuador, Nigeria, Venezuela (especially because of the political regime), Angola, UAE, Oman, Algeria and Kuwait (in addition, termless strike of union petrochemical industry workers since 17 of April).

After the preliminary February meeting and the current "failure" of the summit on 17 of February – both "warmed up" quotes for a short period of their expectations – new key "points of reference" will be the following talks in Vienna in June and the final review of memorandum of "freezing" on 20 of October in Moscow.

Opinions of Analysts…

…divided: for a decrease on $10 (Δ) to $30 there is The World Bank, british Standard Chartered, Japan's financial Nomur Holding, swiss bank UBS, Morgan Stanley and consulting agency on energy MacKenzie. Last Monday the IMF has revised its forecast for the next 2 years in the direction of the average $35 in 2016 and $41 in 2017. Among the optimists are RBC Capital Markets, IEA and OPEC itself, - the last is expecting growth of quotes from the 2nd half of 2016, forecasting $80 in five years, $160 by 2040, 20% growth of global demand for raw materials and increase of investments in the industry by $10 trln.

Current quotes of raw oil:

Source: Thomson Reuters Eikon

By Evgeny Zomchak
Chief Financial Analyst
EqTrades