Oil – suppliers are calling the shots

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One Pager

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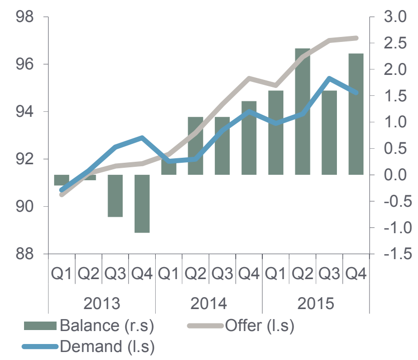
The oil price decline from mid-2014 to early 2016 was one of the largest ever recorded, with a similar drop seen only in the economic and financial crisis of 2008/2009.

Global oversupply

The current oil price trend is the result of global oil production outpacing sales volume since early 2014 (Figure 1). Overproduction in 2015 was approximately two million barrels a day on average for the year. The decline in speculative oil purchases on the forward markets has placed additional pressure on the oil price.

Figure 1: Supply and demand on the oil market

Million barrels per day



Source: IEA, own calculations

Economic conditions can hardly explain the price drop

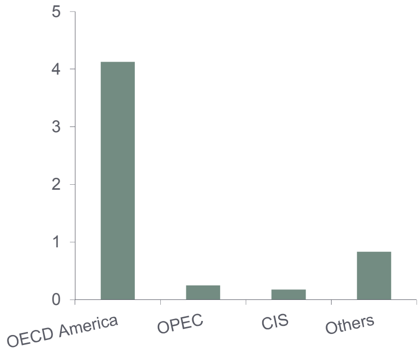
Receding global growth is an inadequate explanation for the oil price decline. Despite the relatively high energy intensity of developing and emerging economies, their declining growth rates had little influence on oil demand, which rose at relatively constant rates of around 2½ % p.a. in the last 3–4 years.

Producers are setting the tone

Responsibility for the decline in oil prices lies with the producing countries. The

Figure 2: Oil supply growth by region (2013–2015)

Million barrels per day



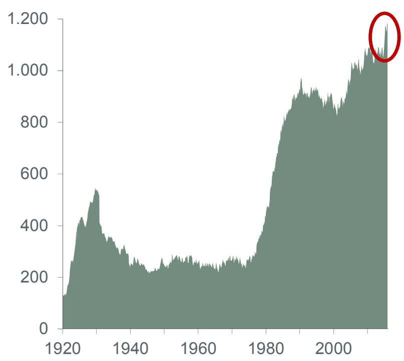
Source: IEA, own calculations

OECD countries in the Americas, particularly the USA, were the initial drivers of this development but also Canada, which is, after all, the world's fourth-largest oil producer (Figure 2). In order to keep their market shares, other producing nations (OPEC, CIS) have also been unwilling to cut their production in order to stabilise the oil price. Some of them have even increased their output in order to stabilise their turnover through quantity.

Even though fuel storage facilities are now filled to the brim (Figure 3), the fracking industry in the USA has not responded by cutting production but merely by halting investment in new fields (Figure 4). It is true that many companies in North America have had to give up (with breakeven prices in the range of USD 50–70 per barrel). However, even at the very low oil price, they still appear to be capable of earning the marginal and borrowing costs with the remaining rigs. Those facilities are thus being used to exploit existing fields to the maximum. As a result, the output per rig in North America has actually risen dramatically instead of falling, especially in 2015. It will not be before the fields are nearly depleted that North American output will drop significantly, giving the oil price room to rise again. Experts predict this process to set in from mid-2016.

Figure 3: Storage levels in the USA

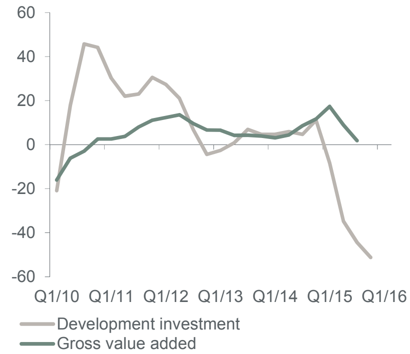
Million barrels



Source: EIA

Figure 4: US mining sector

Variation on previous year in per cent



Source: BEA, Federal Reserve Bank of St. Louis

Conclusion

Structural changes on the supply side are accompanied by an intentional oversupply. Significant oil price increases in the near future are therefore unlikely so long as producers continue their strategy and storage facilities are full. The only way to help stabilise or slightly increase the oil price is through genuine agreements between major oil-producing countries on freezing or cutting production output. ■