

Cheap oil: the new normal?

Atradius Economic Research - April 2015

Summary

- The steep fall in oil price since August 2014 is mainly caused by oversupply.
- The oil sector and petroleum exporting nations are negatively affected by the low oil price; other sectors and countries are expected to benefit.
- We expect a recovery of the oil price starting in 2015 Q4 and accelerating during 2016. For the years thereafter we expect a slower gradual rise in the oil price. Nevertheless we have to emphasise that the level of uncertainty is very high.

Oil price developments

Since August 2014 we have observed a sharp fall in the oil price: from USD 105 to USD 50 per barrel for Brent oil in a period of only six months. Since March, the price of Brent has been hovering between USD 50 and USD 60. As discussed in our latest oil price update in December 2014, the most important causes of the price decline are the rise in US shale production and the unexpectedly strong supply from OPEC. The questions are which sectors and countries are most affected by the lower oil price and how do we expect the oil price to develop over the coming years?

Compared to our research note of December 2014 we are more bearish on the oil price for 2015. The reduction of

Table 1 Sector vulnerability

Sector	Sensitivity to lower oil price
Chemicals	strong positive
Agriculture	positive
Consumer Durables	positive
Textiles	positive
Transport	positive
Construction	neutral
Construction Materials	neutral
Electronics	neutral
Food	neutral
Machines	neutral
Metals	neutral
Paper	neutral
Services	neutral
Finance	negative

Source: Atradius

Table 2 Country overview

	Oil exports / total export	Oil revenue / GDP	Oil revenue / total public revenues	Fiscal break even oil price (2014)	Reserves plus SWF (import cover) (2014)	Oil reserves in years of production
Angola	97	59	81	98	14	19
Azerbaijan	95	45	74	94	63	22
Bahrain	78	49	87	126	11	7
Colombia	51	9	16	92	10	7
Congo Brazzaville	90	69	77	94	19	16
Ecuador	58	16	30	103	2	43
Gabon	88	48	57	92	11	23
Ghana	28	4	3	n.a.	4	23
Iraq	100	44	92	125	18	131
Kazakhstan	65	28	50	85	55	46
Kuwait	94	65	83	44	179	89
Nigeria	84	17	73	117	9	44
Norway	27	26	33	40	80	13
Russia	54	14	30	97	18	24
Saudi Arabia	87	46	93	99	56	63
Trinidad & Tobago	37	18	56	75	22	19
UAE	32	31	65	70	46	73
Mexico	10	3	34	95	6	11
Cameroon	51	11	29	107	6	9
Malaysia	20	15	35	n.a.	11	15
Brazil	1	0	2	n.a.	19	n.a.

Note: Red means poor, Yellow means neutral, Green means good.
Source: EIA, IEA, BP Statistics (2012), Atradius calculations

supply from the US shale producers did not materialise as quickly as previously expected, resulting in prolonged oversupply due to American shale oil.

Sectorial effects of the lower oil price

The effect of cheaper oil is, on balance, good for the world economy. A lower cost for oil implies more purchasing power for other goods and services. The assessment of the impact of the fall in oil price depends nevertheless on the sectorial perspective. For the oil and gas sector the effects are potentially dramatic. Some segments of the US shale oil industry are in dire straits and the same can be said for some of the more expensive (e.g. deep sea and ultra-deep sea) oil and gas projects. However the latter projects have a long-term horizon and the oil price may well be recovered when these projects come on stream. The effect on many other sectors is considered positive however. All industries that use oil as a production factor one way or another (for example transport, petrochemicals and energy intensive industries) as well as households are expected to benefit from a lower oil price. Table 1 summarises the estimated impact on the most important sectors.

The sectorial impact is also dependent on the country structure, with countries that are highly reliant on oil

export being most vulnerable. The finance sector in such countries for example will be relatively more exposed to the oil sector. Also the machines and manufacturing sectors may be closely intertwined with the oil production sector. The risks to these sectors will therefore be negative in countries reliant on oil income.

Country impact

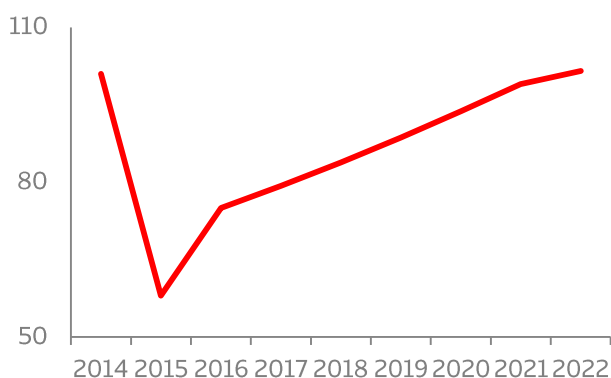
The countries most vulnerable to a lower oil price, and thus to lower income from oil sales, are generally the countries with a very dominant oil industry – those in which the oil industry represents a relatively large share of the national economy. To assess the impact by country Table 2 shows countries that are largely dependent on oil production and export, either for their economy as a whole (GDP) or as a source of income for public finances. This shows that Angola, Azerbaijan and Bahrain are the most vulnerable countries. But Norway and Russia also make the list.

Expectations for the oil price

First of all we have to stress that the oil price developments are uncertain, even more uncertain than normal. Nevertheless we have contemplated a scenario

that we consider the most plausible. For 2015 and 2016 we follow the projections of the US Energy Information Administration (EIA). This is a US government related think tank responsible for the analysis of global developments regarding energy. We expect that the low oil price will hit the US shale industry badly and will result in a significant decrease in active shale oil projects. We have already observed the number of active oil rigs in the US decline (the number of active onshore oil rigs in the US decreased from 1759 to 951 over the past 12 months) and we expect this trend to continue. In the fourth quarter of 2015 this is likely to have a significant impact on oil supply and the price is therefore expected to rise. Nevertheless this rise should not be steep since the strategic petroleum reserves are largely at maximum capacity, especially in the US. We believe the increasing oil price trend in the fourth quarter will result in an average price of USD 58 per barrel of Brent oil in 2015. This increasing price trend is expected to continue in 2016 resulting in an average price of USD 75 per barrel in 2016. In the years thereafter we expect a gradual recovery of the oil price up to USD 99 in 2021. In the period after 2020 the US total oil production (conventional plus shale oil) has reached a ceiling due to the depletion of conventional fields and a gradual decline will take off. This implies that the major cause of the current oil supply will slowly disappear.

Oil price forecast, USD per barrel



Source: Atradius

Risks to the base scenario

As with all predictions of the future there are upward and downward risks. To start with the latter: a disappointing recovery of the oil price could be caused by a quicker than expected recovery of the US shale industry. The industry has shown a remarkable degree of technological innovation and cost cutting in the recent past and this trend may continue. If most shale oil projects manage to

push their break-even cost significantly below USD 70 per barrel (in Brent terms) a structural low oil price could become sustainable.

The effect of a shale oil driven oversupply could be even worse if it would be replicated in countries outside the US. It is known that shale oil reserves in countries like Canada, Argentina, Russia and China are enormous. However the business conditions in these countries are so different (with the possible exception of Canada) that this is not likely in the short-term.

Also the behaviour of OPEC poses a downside risk. As stated above we expect OPEC to resume its traditional role as market stabiliser. This is not a certainty however. If OPEC (read Saudi Arabia) considers defending its market share a key priority and accepts a lower price, also in the medium-term, then the excess supply may continue longer than expected. Apart from the OPEC production decision, another issue has emerged from an OPEC country. The Western powers have reached an agreement with Iran and this may be a prelude to a more extensive deal next year. If the international sanctions on Iran were lifted and Iran would be able to export oil in the same amounts as it did before the sanctions were introduced, this would mean an increase of the global oil supply with 1.5 million barrels per day.

The last downside risk stems from the energy policies of emerging markets. From emerging markets stem the greatest oil consumption growth and a switch towards renewable energy is not a key priority. Nevertheless this might change. We know that China is a centralist state and that air pollution is a severe problem. A sudden switch towards, for example, electric or hybrid cars, trucks and trains would have a significant impact on global oil demand growth.

If these risks materialise, a long-term oil price of USD 70 per barrel (in real terms, thus increasing only with inflation) would be imaginable.

Nevertheless a scenario in which the price of oil goes through the roof would also be conceivable. Further unrest in the Middle East or escalating tensions with Russia would be a possible cause of supply disruptions. Also the large scale cancellation of new oil investment (already underway as it appears that some projects have been cancelled or postponed), could mean that oil supply in the medium-term would be significantly reduced resulting in strong upward pressure on the oil price.

Disclaimer

This report is provided for information purposes only and is not intended as a recommendation as to particular transactions, investments or strategies in any way to any reader. Readers must make their own independent decisions, commercial or otherwise, regarding the information provided. While we have made every attempt to ensure that the information contained in this report has been obtained from reliable sources, Atradius is not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this report is provided 'as is', with no guarantee of completeness, accuracy, timeliness or of the results obtained from its use, and without warranty of any kind, express or implied. In no event will Atradius, its related partnerships or corporations, or the partners, agents or employees thereof, be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any consequential, special or similar damages, even if advised of the possibility of such damages.

Copyright Atradius N.V. 2015

Atradius Credit Insurance N.V.
David Ricardostraat 1 · 1066 JS
P.O. Box 8982 · 1006 JD
Amsterdam
The Netherlands
Telephone: +31 20 553 9111
Fax: +31 20 553 2811

www.atradius.com