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Oil output cap seen as 'grim' reality sets in

Syed Rashid Husain

NON-OPEC output is set to fall, three major global energy agencies – the Paris-based International Energy Agency (IEA), often termed as the OECD energy watchdog, OPEC, the organisation representing the producers and the EIA, the statistical arm of the Department of Energy in Washington – are concurring. Yet they continue to differ on the timing of the eventuality. But the gap is getting smaller.

For a change, not bad indeed!

With markets 'drowning in oil, the IEA Oil Market Report (OMR) for January makes for fairly grim reading, pointing to 'persistent oversupply, bloated inventories and a slew of negative economic news,' as reasons for the recent price drop.

Exceptionally mild temperatures in the early part of the winter in Japan, Europe and the United States – alongside weak economic sentiment in China, Brazil, Russia and other commodity-dependent economies – saw global oil demand growth flip from a near five-year high in the third quarter of last year, at 2.1 million barrels per day (bpd) to a one-year low in Q4-2015 of 1.0 million bpd, the January OMR underlined. The outlook for 2016 too projects demand growth moderating to 1.2m bpd.

However, there was a silver lining for the producers in the report by the IEA too. Although global oil supplies had expanded by 2.6 million bpd last year, following hefty gains of 2.4m bpd in 2014, yet, by last December, growth in supply had eased to 0.6 million bpd. Could this be a harbinger of a changing tide?

OPEC crude output eased by 90,000 bpd in December to 32.28m bpd, including newly rejoined Indonesia, the MOR insisted. And though Iran, now relieved of sanctions insists, it will boost output by an immediate 500,000 bpd, the IEA assessment expects it to be around 300,000 by the end of this quarter (Q1-2016).

EIA, the statistical arm of the US Department of Energy appears a bit more pessimistic. The global market likely won't pull away from the supply side until at least 2017 as crude oil lingers in storage, Adam Sieminski, the head of the EIA told US lawmakers last month. "Inventories are forecast to continue rising in 2016, before the global oil market becomes more balanced in 2017," Sieminski told the US Senate.

In his view, balance would return only in the latter half of 2017. The first draw of global inventories isn't expected until the third quarter of 2017, which would mark 15 straight quarters of a build, Sieminski asserted, as the US oil production was expected to drop off steadily though most of 2017.

However, the Organisation of the Petroleum Exporting Countries (OPEC) is sounding more positive. The market will start to re-balance itself this year as weak prices take their toll on non-OPEC output. "After seven straight years of phenomenal non-OPEC supply growth, often greater than 2 million barrels a day, 2016 is set to see output decline as the effects of deep capex cuts start to feed through," OPEC underlined in its January monthly oil report.

The 104-page OPEC report finds that the greater demand for the group's oil in 2016 would be because the market will be "supply-driven" as competitors, beset by low prices, would continue to cut back severely on capital expenditures ranging from exploration to new drilling. The analysis indicates that 2016 will be a supply-driven market. It will also be the year when the re-balancing process starts.

OPEC hence projects non-OPEC output to fall by almost 700,000 barrels a day in 2016. The US is expected to see the biggest decline in production, with output forecasted to drop by 380,000 bad in 2016 from nearly 13.5 million bad. Other areas that OPEC sees as "particularly vulnerable" because of dramatically reduced capital expenditure are parts of Asia, as well as Canada, Latin America and the North Sea. The report underlined that, for instance, all projects in Canada were now below cash cost.

And though OPEC output is still at elevated levels, yet there are hints of decline too. Secondary sources are reporting that OPEC output declined by 200,000 bpd in December. The group's output – including newly reinstated member Indonesia – fell to 32.2 million barrels a day in December led by lower production in Nigeria, Saudi Arabia and Iraq. In view of the changing scenario, OPEC expects the call on its crude to rise by 1.7 million bpd to 31.6 million bpd by this year. In 2015, as per OPEC, the demand for its crude averaged 29.9 million bpd.

Taking a longer view of the market scenario, Khalid Al-Falih, the chairman of Saudi Aramco, believes the next five years will be critical for the crude oil markets as supply and demand will ultimately balance at a "moderate" price. "Demand will grow, as it has already started in 2015, and there will be a period not far into the future (when) demand will catch up with supply," he said, while speaking on the sidelines of a conference in Riyadh. And then he added, the crude markets may reach a point where there will be tight spare capacity and everybody will be looking to Saudi Arabia to save the world with more supplies.

And apparently in view of its positive outlook, Aramco is continuing to invest in new investment in oil and gas production capacity despite cost cutting due to low oil prices. "Our investments in capacity of oil and gas have not slowed down. We have been able to do a lot of cuts in spending by simply driving down costs," Falih was quoted as saying over a panel discussion in Riyadh.

Yet, headwinds continue to prick sentiments. Global economy is not in a good state. On the heels of the World Bank revising global economic growth down to 2.9 per cent in 2016, the IMF too has cut its own forecast for 2016 to 3.4 per cent.

Deeper-than-expected contraction in countries such as Brazil and the pressure on the US economy provided by a stronger dollar, continue to be worrying signs for the overall health of the global economy. With global economy knocking on the doors of recession, as some insist, fundamentals impacting the oil markets may undergo a sea change.

Environmental threats still continue to hover over the energy industry!

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