- # INGOT BROKERS

OIL PRICE REPORT

In the last 18 months, oil prices have plummeted losing 80% of its value. It came about as a result of the oil shale discovery in the U.S. reducing the world's largest consumers' dependency on oil. This reduced the marginal cost of production for U.S. producers which meant they were happy to accept lower prices for the barrel. As a result, OPEC has collectively been pursuing a policy to protect market share. A year ago Saudi Arabia refused to allow OPEC to try to raise prices by pumping less crude, in the hope that a low price would drive competitors, especially America's shale-oil producers, out of business. Since then it has used its low cost of production to carve out a bigger slice of the pie. It has fought with Russia and fellow OPEC members to sell oil to China.

500,000 barrels per day are expected to flood into the market once the sanctions linked to Iran's nuclear program are lifted by the U.S. and EU. Goldman is currently estimating the bottom at $20 per barrel before producers are forced out of the market. With this in mind, Aramco is forced to tighten its belt and reevaluate the fiscal budget. Prince Mohammad bin Salman views the collapse should be seen as an opportunity to clean up Saudi finances and diversify the economy.

Producers with higher costs, including big listed oil firms and many rival national oil companies, have also behaved rationally, albeit reluctantly, cancelling at least $400 billion of spending on new oil and gas projects which is 27 billion barrels of oil equivalent in reserves. It takes time for this retrenchment to feed into lower production, because oil projects have long lead times, and in the meantime, producers naturally seek to compensate for lower prices by pumping more from existing facilities. But eventually diminished investment will reduce output.

As a result fundamental changes in the supply/demand balance are the key driver of prices and geopolitical factors that previously caused some volatility in prices have had little effect. On the demand side, the IEA stated even in the developing world, the amount of oil consumed per unit of economic output is declining. Besides the severe slowdown in China's economy, China's growth is becoming less energy-intensive. Fuel-efficiency standards are tightening and affect three-quarters of all vehicles sold worldwide.

On the supply side, despite the fact that we are seeing some cuts to production in non-OPEC producers the prospect of Iranian barrels adding to the supply glut is worsening the bearish sentiment. Brent, the international oil benchmark, sank to 2003 lows of less than $28 a barrel. Iranian officials have vowed in recent months to increase output by 500,000b/d immediately after the lifting of restrictions and a further 500,000b/d within seven months. The IEA estimates that 300,000b/d could flow to world markets by March.

In the near term, the speed and size at which these new barrels hit the market have the potential to shift the curve substantially. Although the market seems to already be pricing these barrels in, if the speed and size exceeds expectations we may see a big market correction.