Falling Oil Prices: a Stress Test for the US Shale Oil and the Global Market

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Roundtable summary:

The Ifri Energy Breakfast Roundtable looked at the potential consequences that falling oil prices could have on the US shale oil and the more "traditional" oil exporters. Opening the discussion, Ms Marie-Claire Aoun explained that the US spectacular development of unconventional oil production and the downward revisions of global oil demand were key factors in the recent price drop. The downward trend had also been strengthened by the OPEC decision not to cut their production last November. Consensus is that global oil markets have reached a turning point and the question is how production will react to low prices.

Presenting her recent Ifri study on the US Light Tight Oil (LTO) business model, Ms Sylvie Cornot Gandolphe focused on the impressive increase of the US oil production since 2010 and illustrated the impact on the US oil imports dependency and global trade flows. After describing the characteristics of the LTO business model, Ms Cornot Gandolphe showed how difficult it is to predict the exact impact of low prices on future LTO production because the industry is new and characterized by heterogeneous geological, technological and financial situations. Despite cutting part of their capital expenditures, the US oil companies have announced that they will continue to increase their production, although potentially at a slower pace than in previous years. The LTO industry has also proven to be very innovative. Technological developments are underway and they could lead to rapid improvements in oil recovery rates. Ms Cornot Gandolphe further explained that the LTO business model is very flexible and "price responsive", meaning that production could quickly adapt to price rebounds. In her concluding remarks, she underlined that rebalancing the oil market has become much more challenging with the rise of unconventional production.

The second panelist, Mr Saïd Nachet, put the recent oil price drop into perspective, by drawing a comparison with previous oil price declines and current price developments for other commodities. Discussing the role of OPEC, he emphasized the fact that the group does not necessary act as one set of players sharing the same views on members' production decisions. Saudi Arabia's strategy to defend its market share in Asia, against the backdrop of raising shares of other producers such as Iran and Iraq, has led the main OPEC player to heavily discount its cargoes for Asian buyers. Regarding visible and potential impacts of lower oil prices on stakeholders, Mr. Nachet noted that the oil consumers are benefitting from this situation. This positive impact also includes the refining sector, whose margins have improved, leading to a surge in the global refinery crude throughputs. For the major consuming countries with large crude oil production such as the US, the producing

regions are affected by the oil price decline, but according to many studies, the overall impact is positive. Discussing future developments, Mr Nachet noted that both the World Bank and the IMF had recently revised their economic growth forecasts downward and he insisted on the fact that the oil price level is linked to the supply-demand balance and remains dependent on the macro-economic situation.

Lastly, Mr Francis Perrin shared his analysis on how producing countries, in particular Arab countries and those of the Gulf region, were reacting to both the growth of unconventional production and the recent decline in oil prices. On the first issue, he stated that "traditional" producing countries acknowledged that unconventional production was a serious and lasting trend, which could also be seen as an opportunity. It has led to an upward revision of the global reserves estimate, reassuring consumers on the durability of oil production. These countries are also determined to develop their own unconventional reserves and some of them are adopting international strategies in order to invest abroad in the downstream and upstream chains. They are also seeking to diversify their energy mix, notably towards renewable energy and nuclear. Regarding falling oil prices, Mr Perrin highlighted that the first consequence for producing countries is to the need to adjust their state budgets based on a lower price assumption. Because preserving the social and political stability is a priority, the budget cuts are unlikely to apply to the state's core missions, such as healthcare or education. More broadly, no major policy review is foreseen due to the conviction that oil fundamentals are robust in the medium and long term.

The Roundtable ended with a Q&A session. Among other issues, panelists and participants further discussed the strategy of OPEC members, the potential impact of tax incentives, the US energy policy on the US LTO production, and the evolution of gas pricing schemes.