

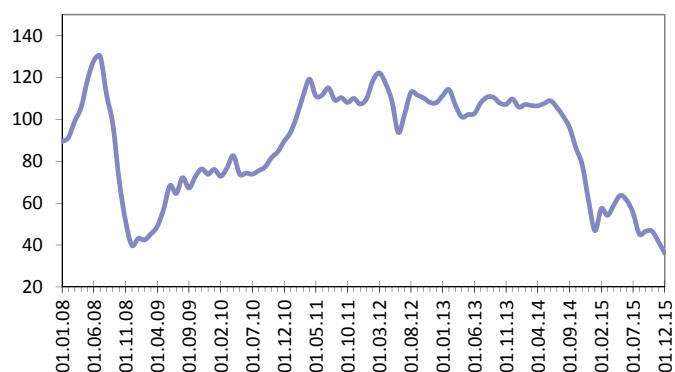
## OIL MARKET: NEW REALITY

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Amid low crude oil prices resulting from the excessive supply over demand, oil production at high-cost deposits began falling, drastically decreased investments in the development of non-traditional deposits including shale oil in US. However, falling oil production at the high-cost deposits is offset by the oil production growth in leading OPEC member states, which aim for expanding their oil market share. Russia has also increased oil supplies: in 2015, its oil production peaked its maximum over the period since 1990 and the oil export has reached its all-time record. Moreover, due to the lifting of sanctions on Iran one should expect a significant increase of supplies from that country. On the whole, the oil market outlook is characterized by predominance of factors, which will contribute to preservation of low world oil prices.

Recently, the world oil market boasts of a sustainable excessive crude oil supply over demand, which resulted in a significant reduction of oil prices. Production of shale oil in the United States is the main factor of the global supply growth. It was due to application of the latest production technologies and high oil prices over previous years.

Furthermore, despite price reduction the OPEC refused to cut the oil output quota proceeding to the policy of maintaining their share of the global crude oil market. As a result, in 2015, Urals crude oil price averaged \$51.2 per barrel, which was nearly half (by 47.6%) the price of the previous year (Table 1). In the meantime, in January, August and September 2015 Urals crude oil price averaged \$45–47 per barrel and in December averaged \$36.2 per barrel (Fig. 1). In January 2016, the oil price decline continued. In mid-month, it dipped below \$30 per barrel. Thus, the low oil prices became the new normal of the crude oil market.



Source: OECD/IEA.

Fig. 1. Price of Urals in 2008–2015, \$/bbl.

Table 1

WORLD OIL PRICES IN 2012–2015, \$/ BBL.

	2012	2013	2014	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2015
Brent crude oil, Great Britain	112.0	108.8	98.9	54.0	62.1	50.0	43.4	52.4
Urals crude oil, Russia	110.3	107.7	97.7	52.8	61.4	49.1	41.5	51.2

Sources: IMF, OECD/IEA.

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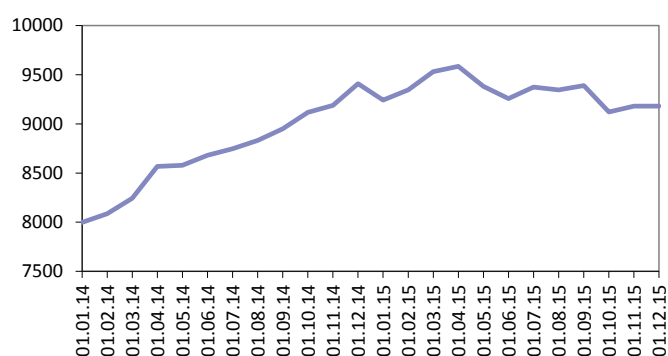
The latest data demonstrate that in 2015 amid low crude oil prices output at the high-cost deposits was terminating. The investment activity fell sharply. The US reached peak oil output of 9.585 mn barrels per day in April 2015, thereafter its production began falling to 9.18 mn barrels per day in December or by 4.2% in comparison with the April maximum (*Fig. 2*). Oil production is falling in other high-cost regions: Norway, Great Britain and Mexico.

In the wake of low crude oil prices investment in the development of the most high-cost unconventional deposits: shale oil in the US, oil-bearing sand in Canada, deep-water fields in various regions, fell sharply. For example, the rig count in US, which represents the investment activity indicator peaked 1,596 in October 2014, whereupon steady decline began (*Fig. 3*) to 537 rigs in December 2015. In other words, the rig count shrank by 66% over this period. This will result in further decline of crude oil production in US.

Contraction of high-cost oil production could have reduced excessive oil supply and create preconditions for the increase of the world oil prices. However, the serious issue is represented by the OPEC policy aimed at expanding their oil market share. For the countries whose income mainly depend on the oil export, low crude oil prices strengthen incentives for the expansion of their market share. By increasing their supply volumes, they tend to offset at least partly the revenues contraction due to falling prices. As a result, contraction of crude oil output in the high-cost regions is currently offset by an increase of crude oil production by the OPEC member states.

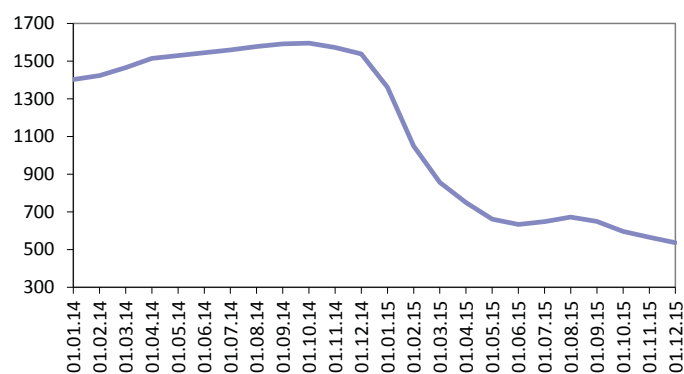
In Q4 2015 in comparison with the same period of the previous year, total crude oil production by Saudi Arabia and Iraq, leading OPEC member states by production volumes, has gone up by 1.28 mn barrels per day, including by Saudi Arabia – by 0.44 mn barrels per day, in Iraq – by 0.84 mn barrel per day (*Table 2*). As a result, there is a sustainable excess of the production quota set by the OPEC member states (30 mn barrels per day). Moreover, in the near future due to the lifting of sanctions on Iran the latter will increase oil supply, which is the third largest OPEC oil producer.

Russia has also increase crude oil supply on the world market. Despite the fall of oil prices and imposition of financial and technological sanctions on Russia, oil output maintains positive dynamic (*Table 3*). In 2015, Russia produced 533 mn tons of crude oil, which is the maximum level since 1990.



Source: US EIA.

Fig. 2. Oil production in US in 2014–2015, thousand barrels per day



Source: Baker Hughes.

Fig. 3. Number of active rig count in US in 2014–2015

Positive impact on the oil production was due to significant investments over recent years, ruble devaluation as well as tax burden reduction following the decline of world oil prices. Total export of oil and petroleum products in 2015 according to preliminary estimates exceeded 400 mn tons, which is all-time high<sup>1</sup>. Increase of Russian oil export is due both to growth of oil production and contraction of domestic consumption amid economic slump. At the same time, one should note positive impact of the tax maneuver<sup>2</sup> implemented in the oil sector. It resulted in significant reduction of fuel oil export and increase of crude oil export, which is more productive for the state budget than fuel oil export.

Table 2

**OIL PRODUCTION IN US AND OPEC IN 2014–2015, MN BARRELS PER DAY**

	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4
USA	8.14	8.61	8.84	9.25	9.49	9.50	9.43	9.30
OPEC, total	30.01	29.70	30.28	30.34	30.32	30.96	31.34	31.19
Saudi Arabia	9.80	9.65	9.70	9.63	9.73	10.07	10.22	10.07
Iraq	3.26	3.29	3.28	3.53	3.57	4.03	4.33	4.37

Source: US EIA.

Table 3

**PRODUCTION AND EXPORT OF OIL AND PETROLEUM PRODUCTS IN RUSSIA IN 2012–2015, IN % TO CORRESPONDING PERIOD OF PREVIOUS YEAR**

	2012	2013	2014	2015 January– November
Oil production including gas condensate	101.3	100.9	100.7	101.3
Crude oil export	98.2	98.6	94.4	107.6
Primary crude oil processing	104.9	102.7	104.9	97.2
Production of regular gasoline	104.3	101.3	98.8	102.3
Production of diesel oil	98.7	103.1	107.4	98.5
Production of fuel oil	101.6	103.3	102.0	91.5

Sources: Rosstat, Ministry of Energy of Russia.

Russia's potential in sustaining crude oil production to a significant degree will depend on the level of world oil prices. In particular, development of new deposits will depend on this factor.

The current oil market outlook is characterized by a number of factors, which will contribute to the preservation of relatively low oil prices. Among the most significant ones are: considerable deposits of shale oil in US, which will be rapidly developed and will increase supply in case of the world oil prices above \$60 per barrel; slowdown of economic growth in China; falling discipline in OPEC; increased tension between Saudi Arabia and Iran as well as increased crude oil supply by Iran resulting from lifting of sanctions linked

1 See: Yu. Bobylev. "Development of Russia's Oil Sector". *Voprosy ekonomiki*. 2015. № 6, pp. 45–62.

2 See: G. Idrisov, S. Sinelnikov-Murylev. "Modernization or Conservation: the role of the export duty on oil and petroleum products". *Ekonomicheskaya politika*. 2012. №3, pp. 5–19; Yu. Bobylev. "Tax Maneuver in the oil sector". *Ekonomicheskoe razvitie Rossii*. 2015, №8, pp. 45–49.

to the realization of its nuclear program. In this context, the most feasible prospect for the oil market will be low world oil prices in the years to come.

According to the latest forecast of the US Energy Information Agency released in January 2016, in the current year Brent crude oil price will average \$40.15 per barrel. In the event of the realization of this forecast, the price of Urals crude oil will average \$39 per barrel in 2016. ●