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Oil Price War and China

When it comes to lower oil prices, China is well-positioned to take advantage of decreasing import deficits and consumer toll. However, for the last decade, it was custom to hear that "World's economic gravity is shifting to Asia or East." In such an environment, China is not just a simple consumer paying for the oil bill, but it has broader implications beyond its borders.

Starting from the most apparent result of low prices, China will benefit. By increasing imports and stock levels, it has a degree of control on the slippage of price. Oil is also related to other commodity prices. Lowering of these commodity prices in the short run mixed with government support for the economy is a kick for the virus hit economy. China is also one of the biggest oil producers. It is producing close to 3.8 million barrels/day. We are not sure how much the Coronavirus hit that production. However, China was producing 4.3 mb/d in 2015, and its production has been recently stabilized. The problem with this production is its cost. Rystad energy vice president claims the cost for Chinese production is 41$/b.

Oil-producing countries subsidize their essential services(like food) through oil revenues. Both oil consuming and producing countries generally lend a helping hand to their oil and gas industry during these low oil prices. So with low oil prices, the Party has to help upstream state-owned enterprises. Sinopec, PetroChina, and Cnooc are expected to increase spending despite losses. According to Bloomberg, China's biggest three oil producers raised their spending %18, but PetroChina's shares fell 20% when Asia Energy Index rose %6. It is just plain economics. Low prices hit the high-cost producers first.

Chinese President Xi Jinping, like any other developing country, is aiming for energy and hence oil self-sufficiency. Price war will hit self-sufficiency targets, national oil companies, and high-cost production fields. Assuming prices stay low for some time, its impact may be more structural. It may also delay the Chinese shale revolution to come for some time.

The other problem is the secondary effects of Chinese expansion. China has given resource backed loans to some prominent resource-rich countries. Venezuela, Brazil, Angola, DRC, and the Republic of Congo are the receivers of such credits, according to The Chinafrica Project. These repayments of these loans are now on the riskier side than before.

Regarding natural gas prices, the effects are complicated. Most of the US shale production was producing associate gas. Well closure and decreasing oil production will support gas prices. Low oil prices will impact LNG and long term contracts differently. IGU report does not provide details about Chinese contract space, but oil-backed contracts are still relevant. Thinking about US-China trade deal and removal of Chinese tariffs on US LNG, if Henry Hub prices increase, LNG cost is expected to increase. Overall the result will be mixed. The biggest problem is regarding the third country. Wall Street Journal published a story regarding why Coronavirus has hard hit the Qum city in Iran. They claim it on close Chinese collaboration and Chinese projects around that region. If low oil prices hit these already struggling oil-exporting economies, most of the Chinese projects may need a rethink.

Another interesting development was about freight rates. After Saudis cut the crude prices, there was a rush in demand for tankers. At the very least, in a contango market, you store oil until prices increase. China's biggest oil trader Unipec is trying to cancel some cargoes due to spike in freight rates. Tanker charter costs nearly tripled with the Saudi price attack.

Therefore the whole situation is mixed. China may recover earlier than western economies. The stimulus package may bring back demand faster than anticipated. But China is not an island anymore; it is very close to the heart of the global system and has connections with the whole world. Just a simple oil price import calculation will be an underestimation of broader impacts.

In a country dominated by state-owned enterprises, the effects of low oil prices from the governmental level to consumer level has varying results. But the primary impact assessment should be made regarding Belt and Road Initiative and its future.

Barış Sanlı

The Dawn of Big Shale

We are currently living through historical times of volatility in the financial markets. The prices at the opening bell do not at all indicate the overall direction of the intraday price movements but rather reflect the magnitude of the differing views on the direction markets is heading. However, the cautionary and relief packages being announced by broad public and financial institutions in the wake of the coronavirus outbreak is reflecting a different reality on the energy sector we previously did not include in future estimates.

The potential economic shock of the coronavirus sparked a panic selloff in the financial markets, and the risk-on attitude of the sector turned risk-averse faster than expected. The lowered oil demand and the oil glut presented by the proposed introduction of around an extra 3.4 mmb/d capacity by Saudi Arabia and the United Arab Emirates alone was enough to drop the prices by over 30% in less than a week. The extra 500,000 mb/d output being proposed by Russia is another factor creating pressure on the prices. These numbers may have been welcome at a certain scenario where the global growth would be at a strong stage. Still, the weakness in the economy created by the coronavirus is the game-changer in our current scenario.

The distress in the OPEC+ arrangement could be examined in greater detail. Still, today we have a different focus where the current moves will certainly be having an immediate effect on—the U.S. shale. Multiple factors need to be taken into consideration when analyzing what might wait for this volatile industry. Being driven by free-market dynamics when compared to its global competitors, including the publicly backed National Oil Companies (NOC's) or the Western Oil Majors, the shale industry is affected by a multitude of different factors. The Permian Basin producers, in general, need $50 per barrel at a minimum to stay cash-flow positive while certain producers in the U.S. can stay that way in between $30 - $50 per barrel. But with the current influx of excess supply by Saudi Arabia that is especially targeting the U.S. market, as a result of the gap between WTI and Brent closing, the U.S. shale producers are under immediate danger of being pushed out of the market.

U.S. President Donald Trump's decision to increase the size of the U.S. Strategic Petroleum Reserve's by 90 million barrels remains relatively outdone in the face of the increase of production and the proposed expansion of production capacities. Still, it should provide an extended lifeline for many of the U.S. producers. Sooner or later, U.S. shale producers will have to slash production to cut down on their capital and operating expenditures, and it could leave the U.S. market particularly vulnerable for entry of foreign oil supplies as the gap between the WTI and Brent could inch closer. The implied market effects of this can already be seen as the stock prices of major shale players including Occidental(NYSE: OXY), EOG(NYSE: EOG) and Apache(NYSE: APA) have tumbled in the recent weeks, and the banks that are particularly exposed through credit to this sector are under scrutiny by investors. The risk-averse attitude of the capital markets, where most of these exploration firms acquire their funding needs, could indeed move away from providing further funding as the general market conditions and the sector-specific conditions deteriorate. This outline could create significant funding problems for the repayment of the maturing shale-debt that has long been the topic of many forecast scenarios.

Hence enter the oil majors. The 1990's oil crises that created the current oil majors could turn out to play once again. While the recent acquisition of Anadarko, one of the biggest shale players, by Occidental has left the firm particularly cash-strapped and presents a case for why mergers/acquisitions at the small-to-mid bracket cannot be done rationally under the current conditions, the oil majors have suffered less of a setback throughout the present crisis, and the potential for acquisitions of the small shale players by these large majors could soon turn out to be the case. This scenario is being created with the thought that most of the present shale players cannot go down the $30 per barrel cost line with the addition of inadequate funding through worsened capital market conditions. Since 2016, the trend of mergers among the small firms of the oil patch was visible, and the current crisis could serve well as an accelerator for the trend.

While no light can be seen at the end of the tunnel for a pick-up in demand for oil in the real economy, the measures being taken by the U.S. authorities for protecting the domestic players without any direct intervention can only serve to be of help in the short-term and present no real long-term solutions for the oversupply crisis brewing in the markets. The small U.S. shale producers lived and adapted through the 2014-2016 price war, but the lack of any real growth in the economy presents new parameters for the crisis at hand this time. Unless a new technical breakthrough can be achieved and no real intervention is done in the markets, then we can expect to see swift and sizeable movements in the markets with regards to the market share and operating structures.

Not all hope is lost for the American shale producers. The possible decrease in production throughout the Permian fields would also decrease the production of associated gas, which the shale wells are known to be producing at significant quantities. According to recent market analysis, this could open up a new opportunity for the Marcellus producers where gas is produced and capitalized upon as the consumption of gas is done primarily on the Eastern Coast of the U.S. Interestingly enough, this time, an increase in the gas prices could help the local and regional economies. A counterargument to this forecast would be that as oil becomes cheaper and cheaper with the potential of a wild upturn in the mid-term, underground gas storages across the world could be dumped into the global markets for reutilization as oil storages. This thought rests on the fact that at the current production rates, most of the existing storage capabilities in at least the U.S. would run out in less than a year, and new facilities or depleted wells would be needed to store the cheap oil. For traders, this could serve as a great arbitrage opportunity but also create a temporary, but effective, supply glut pressure on the gas prices.

Whatever case it turns out to be unless the oil-price war wanes and reverts to the conditions it was in a year ago, and the U.S. oil market structure will not look the same in a year from now on. If past examples are of any significance for forecasting, then we can expect to see new major oil producers forming or small firms joining the ranks of the existing majors.

Alpcan Efe Gencer

2020 Oil Price War: Iran

Oil Price War began on 8 March 2020 with Saudi Arabia's increase of oil production and proposals of up to 8 USD discounts per barrel. The action was taken because of disagreements between OECD countries and Russia on cutting oil production during the 2019–20 coronavirus pandemic. Oil prices had already fallen 30% since the start of the year due to a drop in demand. Saudi Arabia's initiative caused a huge decline in already low oil prices, with US oil prices falling by 34%, crude oil falling by 26%, and brent oil falling by 24%. Following day, with the combination of price war and fears over the coronavirus outbreak, stock markets worldwide reported major losses. US shale companies, Russia, Saudi Arabia, have experienced severe impacts due to this conflict. Still, petro-states such as Iraq, Iran, Algeria, and Nigeria are the ones that are hurt by it. Especially for Iran, domestic turmoil seems imminent.

When the Oil Price War occurred, Iran was already dealing with several problems. Having over 12.000 cases of Coronavirus (COVID-19) and 1000 deaths, the entrance of over 400 billion locusts to Iran soil and massive trade sanctions were not enough for Iran so that an oil price war emerged recently. As a petro-state, Iran completely relies on its oil exports to uphold its economy. Break of the informal alliance between Saudi Arabia and Russia promise that the new prices of oil may be the normal prices in the long term. Hence, these new prices are not the ones Iran can survive on. By many experts, it is stated that the fall in oil prices is more critical for the country than Western sanctions, which are continuing for several years now.

On the other hand, there are some views opposing that Iran will fall into the unknown. According to these views, Iran is already an outlaw to some extent due to being labeled as a terrorist country by the US and dealing with large sanctions. Thus, if Iran can continue to produce as much oil and gas as it can for whatever it can get, generally to Asia and Eastern Europe, in whatever ways that it can, one might observe an increase in the oil and gas revenues. They were already shipping products to the East and Africa on vessels that then 'disappear' from tracking, so this approach is not new. However, increasing its share in the energy market would decently boost Iran's economy in the long term.

As a result, it seems that stability for the country is up to Iran's decision-making on important subjects. The government acted carelessly with Coronavirus outbreak, and now they are enduring the consequences. They feared backlash from the public in the domestic elections, and the story did not end well. Nevertheless, no matter how Iran is sitting on a powder keg or not with the price war situation, it all depends on how the country is taking action towards it.

Yiğit Mert Yüreklitürk

Oil Price Crisis and the US

Oil prices have started to drop on February 21 at an exponential rate and have continued to drop until March 9 from 58 USD per barrel to 34. It has resulted in various changes to the US economy and economy of the world and resulted in a panic amongst global investors in what could be called a stepping stone to a global financial crisis or a recession. According to Huffington Post, this has been the greatest single-day drop in oil prices since 1991, which was the result of the Gulf War and the 1990 oil price shock.

In response to the price war between Saudi Arabia and Russia, White House is considering a bailout (low-interest government loans) to the US oil industry, especially to drillers. However, it is unclear what this bailout would achieve, and The American Petroleum Institute (the most prominent oil lobby in the US) commented on it saying they are not asking for a rescue and are not negotiating with the administration.

US energy industry and some particular state economies such as Texas, Pennsylvania, and North Dakota have boomed thanks to the developing fracking industry, which produces shale oil from hydraulic pressure in the last 15 years. However, these industries rely heavily on investments, and shale oil producers gain their investments mostly from bonds they issue.

According to a Wall Street Journal analysis, 30 largest shale producers in the US have lost 50 billion dollars between the years 2012 and 2017. Furthermore, from 2015 to 2016, 91% of all corporate debt defaults were from the oil and gas industry. It has naturally resulted in unhappy investors. Ed Crooks, the vice-chairman of the energy consultancy firm Wood Mackenzie has stated that this crisis would improve the industries' productivity and commercially and financially sound behavior since the companies would not be acting with complete trust in a bailout from the US government. He also said that unlike a bailout to the banking industry, a bailout to the energy industry would not be saving a vital business for the economy to keep running, since there is a possibility of importing the necessities.

Of course, on the political side of things, swing states that are essential for a presidential campaign, especially Pennsylvania, might be getting more attention from the candidates since the state's GDP relies heavily on the fracking industry and jobs created from it. The crash in the market could also result in a drop of approval ratings for POTUS Donald Trump, who does not seem to be reacting to the crash apart from the bailout it had offered to the drillers. However, on March 9, when the oil price has seen its lowest, Trump tweeted that along with Saudi Arabia and Russia, Fake News was also a reason for the market to drop. Trump further tweeted that the price crash was good for the consumers.

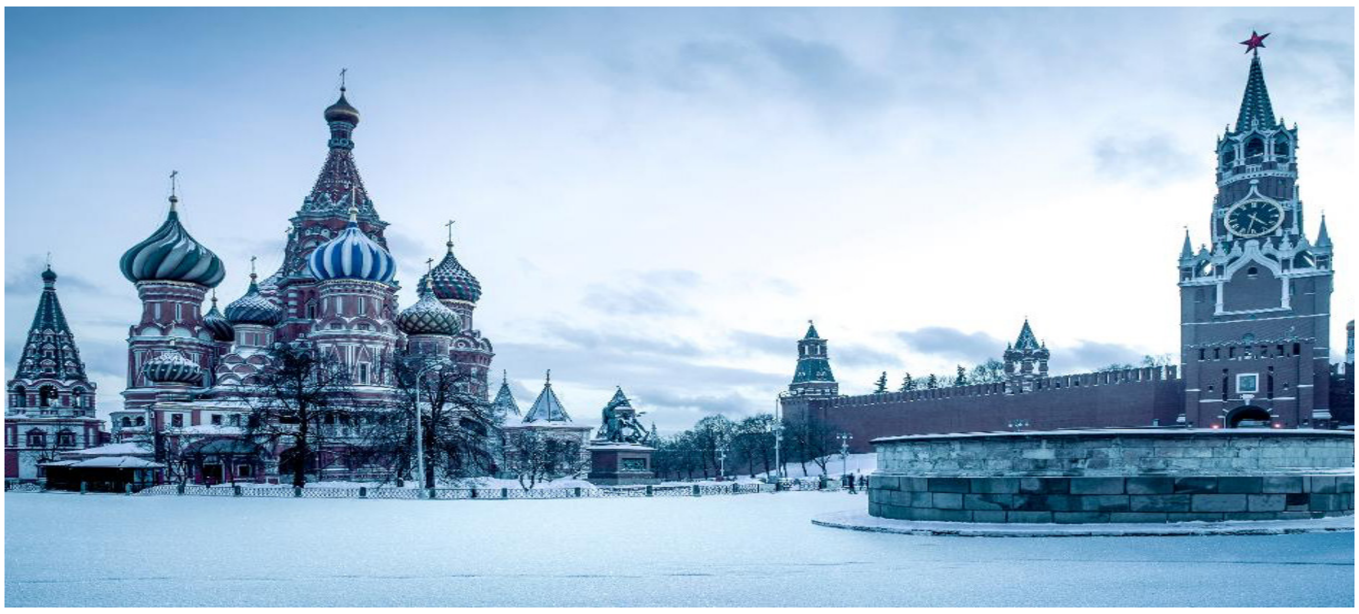
The DOW Market Index has dropped by 5,000 points as a result of the price shock. Of course, with the combination of coronavirus and oil shock, analysts are having difficulties with predicting future oil prices and oil demand. Energy consultants are giving vast price ranges that vary between 21 USD to 44 USD for the year 2021. Some companies say oil prices could go down to 27,80 USD per barrel.

It should not be forgotten that although the price looks stable for now, it could still go down under analysts' predictions. The crown prince of Saudi Arabia, Mohammad Bin Salman, has taken a direct approach to solve the conflicts within OPEC+ by competing with Russia and increasing its oil productions, disregarding the demand for it. They are now trying to pass the 10 million barrels production a day milestone, but their final milestone is 12 million barrels a day. With the predicted decline or a stale oil demand resulting from precautions against battling coronavirus, oil prices could decline even more in the future. What the US should be careful about is if the oil demand increases as the economy and world stabilize over time, which the world would be buying oil from. Since the Saudis are increasing their production while the demand decreases, the world's biggest oil producer US (with 12.2 million barrels a day) will face competition as the vast stocks of Saudis will be ready to be sold after stabilization. Of course, it should not be forgotten that the US does not export all of the oil it produces as they have to satisfy their own countries needs as well. Therefore, the US should not be as calm as it seems now about the oil price crisis since after the wind blows, their economy could face an even more significant impact.

Canberk Taze

BRENT OIL	36.94 $/BL	GASOLINE	5.45 ₺/LT
USD/TRY	6.46	DIESEL	5.75 ₺/LT
EUR/TRY	7.09	FUEL OIL	2.47 ₺

Russia's Reaction to Oil Price War



Revenues from hydrocarbon exports have mostly driven the Russian economy; even though the percentage of oil and gas export share in the Russian economy started to decline (in comparison to the 1990s), it still constituents an essential part of it.

A few months ago, international benchmark prices of oil were trading around $50 per barrel till the fail of OPEC and Russian oil cartels to agree on the production cuts. As an outcome of this agreement price of a barrel of oil started to decrease rapidly. Of course, the economic side effects of the Corona epidemic, weakening of Asian and European markets, also contributed to the fall of oil prices.

On March 9, 2020, after the OPEC-Russian meeting, prices dropped by 30%, which was the worst recorded fall in the last 30 years.

Russian Finance Minister Anton Siluanov indicated that even if the price of a barrel of oil drops to $30, the Russian economy can compensate that and continue its operations for four years. Moreover, Russian Minister of Energy, Aleksandr Novak, stated that Russia could increase its production further up to 500.000 barrels a day. On March 12, 2020, Russian Prime Minister Mikhail Mishustin made a speech in the cabinet meeting. He assured that the Russian economy is under control and has enough reserves to maintain financial stability.

However, experts such as Karen Vartapetov, are skeptical. He claims that Russia can hold on not more than three years if oil prices continuetoremainat$35perbarrel.

On the contrary, some economists like Vladimir Tikhomirov argue that even if budget spendings stay the same and oil prices remain at $35 National welfare fund should be sufficient enough to support the budget up to five or six years. It is hard to estimate in the existing informational convergence. The only thing for sure is, as Tikhomirov states globally majority of the oil producers will not be able to withstand current pricing (approximately $35/barrel) for long. As a result, production will fall, and prices will rise again. In between this period, oil producer states will experience direct economic losses.

When it comes to domestic consequences, Russians, especially the middle-income families, are scared of the possible long term consequences such as controversial changes in the national pensions and tax increases.

In response, at the beginning of the year, to stabilize the domestic concerns, the Russian president Putin called for an acute enhance in federal spending (around $65 billion). It increased payments to families with more than two children to make sure that they can meet their basic needs.

Nevertheless, this week the Russian Rouble lost 7.5% of its value while the oil prices continued to fall. Under these circumstances, it is highly likely that the Russian government will postpone some of the planned subsidies to the next years.

Before this crisis happenend, Putin was also working on securing his position as a leader of Russia by changing the Russian Constitution. If this policy becomes successful, the Russian president will be able to stay in power until 2036.

Still, to establish the idea that no one else is capable of protecting Russian interests than Putin, he must convince the supporters by providing economic subsidies. Under these circumstances, following these policies with the oil price war may increase the burden on the government enormously.

Overall, Russians and Vladimir Putin have many subjects that need careful considerations. In 2014, in the Ukrainian case, Putin managed to gain the support of its people; however, his task is much harder this time.

Yüksel Yasemin Altıntaş
Gökberk Bilgin

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Publisher: Bilkent Energy Policy Research Center
Editor: Gökberk Bilgin
Contact: eeps@bilkent.edu.tr

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