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Oil price may drop another $20 by the end of Q2

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Chairman of the Facts Global Energy consultancy revealed the figures to delegates at AOGC 2015

Oil prices, trading around $67 per barrel, could drop another $10-20/b by the end of the second quarter this year, Fereidun Fesharaki, chairman of consultancy Facts Global Energy (FGE), told delegates to AOGC 2015.

During his Crystal Ball presentation, Fesharaki said there has been no demand response yet and that production of oil is still much larger than the market can absorb.

Inventories continue to fill up, while traders are holding long positions in the paper markets, which are very nebulous and could easily be easily triggered into liquidation.

But “you need a trigger and when it comes, there will be a drop in the price of oil anywhere between $10-20. Now what the trigger is I don’t know,” he added.

The trigger could be Opec not taking any action at their meeting on 5 June, or signals that a substantial increase in Iranian oil production will unfold, or some other news, possibly slower demand growth.

But with pries at $60/b, US production will continue and Saudi Arabia’s strategy – keeping its taps open – aimed at forcing US producers to cut back output may not succeed.

Thanks to improved efficiency and innovation most US unconventional oil output is viable at $50/b, Petronas’ chief executive Datuk Wan Zulkiflee Wan Ariffin, said.

FGE’s basic scenario sees oil prices trading within a range of $50-80/b over the coming years. The consultancy does not see prices going over $80/b, as higher cost wells would start flowing again, thereby pushing prices down.

For prices to climb above the $80 mark, Saudi Arabia would need to rein in its production. But Saudi Arabia will only slash output if they see other people

cutting back as they want to protect their market share, which once surrendered would be hard to claw back.

Riyadh wants to see the US production growth stop and Iraq to accept output quotas. But the Iraqis, who have as much oil as the Saudis, will not consider cutting back until they are pumping 7m barrels a day (b/d), which is far from being realised, reckons Fesharaki.

Prices could trade even lower too, in the $40-60 range, but this assumes massive cost reductions of 20-30% in oil production, he added.

Expectations of a major change in production from Iran, as the US is expected to ease sanctions that have more than halved Iranian oil exports since 2012 to about 1 b/d, mainly to Asia, could play a big role too. Sanctions could be suspended as soon as June, said Fesharaki.

Iran’s deputy oil minister Rokneddin Javadi expects his country’s oil exports will return to pre-sanctions levels within three to six months once an agreement is sealed with the US.

But whether Iran can sell all those volumes into a weak oil market remains to be seen.

“There are many questions. Will Iran accept any Opec quotas beyond what exists. It’s not a question of capability to produce, it’s a question of marketing, and being able to get a reasonable price,” said Fesharaki.

Saudi Arabia could increase its production as soon as Iranian sanctions are lifted to make it tougher for Iran to gain market share. But many buyers still want to diversify and would like to buy from Iran.

“It’s going to be a very challenging time for everyone in Opec, especially for those increasing production, whether it’s Libya or Iran,” he added.

Lower oil prices have also led to lower fuel subsidies, which has in turn hurt demand growth. Malaysia, Indonesia and India have all removed or scaled back oil subsidies.

As lower oil prices bite governments across the Middle East, where demand growth was stronger than in China last year, many governments are being forced to slash fuel subsidies.

This is significant for the oil markets, as the number one area for demand growth is going to slow, said Fesharaki.

Global demand growth is expected to hit 1-1.1m b/d this year. This compares to 2010, when oil demand growth stood at 3m b/d after oil prices last collapsed following the 2009 financial crisis.