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# The Economic Transformation of the Caspian Region and the Falling Price of Oil

Professor Yelena Kalyuzhnova

Vice-Dean International, Henley Business School, Director of the Centre for Euro-Asian Studies

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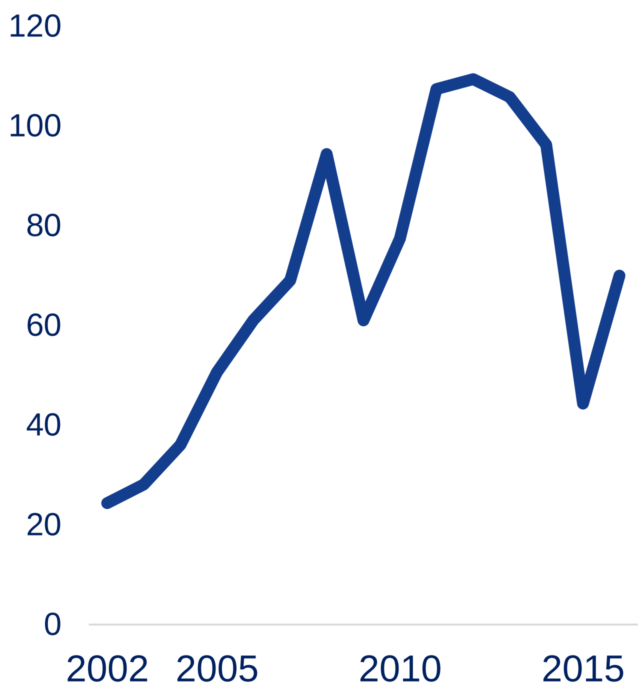
- Lower oil prices – less investment
- Response by different countries
- Key players in the international financial landscape
- Conclusion

# What is the “natural” oil price?





Oil price – annual average USD/barrel




- Global oil production trends
  - Growth in US shale oil and condensate
  - Still high Russian production
  - Saudi Arabia does not want to be the global swing producer
  - Iran under sanctions
  - OPEC does not agree on the strategy
- Demand for oil and gas
  - Less growth in China for oil
  - Less consumption of oil in Europe and US
- The market battle
  - Nigeria, Angola, Saudi Arabia, Venezuela have to replace the US as their main market

# World Oil Demand: and then There Was None (I)

- Slowing global economic growth;
- Rising global oil production (especially in North America);
- Unexpected resumption of oil production in Libya, Nigeria, South Sudan and Iraq;
- Increasing energy efficiency, a response to three years of oil prices in excess of $110 per barrel, which is in turn, had an impact and continues to impact long-term global demand;
- A decision by Saudi Arabia in August 2014 to cut oil production by 400 thousands barrels per day, an attempt to defend its market share in the face of falling global oil prices;
- Record oil output from Russia;
- Surging natural gas liquids and hydrocarbon gas liquids production outside the OPEC quota system;

# World Oil Demand: and then There Was None (II)

- Natural gas eating away oil's market share as a refining fuel and as a feedstock in petrochemicals;
- The decision by Japan to restart some of its nuclear reactors, reducing forward demand for fuel oil in the power sector;
- Dumping of oil onto the marketplace by hedge fund managers who had gone long on oil prices (by some estimates as much as two million barrels per day) in anticipation of further price rises- the hedge funds had no alternative but to liquidate their positions when the market turned against them.

# Lower oil prices threaten investments

- Shell, BP, BG, Chevron, ConocoPhillips, CNOOC, Statoil are cutting cost from 13% to 20%
  - Less money for new projects
  - Less money for exploration
  - More focus on reducing operating costs
  - Some – but not all – are reducing return to shareholders
- Major global projects are on hold
- Some are still profitable
  - The huge Johan Sverdrup field in Norway
  - Projects in the Santos basin in Brazil
  - Some of the larger discoveries in Gulf of Mexico
  - Projects in the Middle East

Johan Sverdrup – Norway's largest discovery since the 1980s

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# The strategy in the Middle East

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King Salman maintains the Saudi strategy. Keeping Al-Naimi as oil minister

- Saudi Aramco can produce 12 million barrels per day, but is satisfied with some 9,5 mill b/d
- Increased focus on development of gas resources to meet fast growing domestic demand for natural gas
  - $7 billion program
- Huge increase in downstream
  - New refineries and petrochemical plants
- Abu Dhabi is entering new agreements with IOCs
  - Total has signed an agreement with Adnoc for 40 år
  - Developing 15 fields onshore
  - Shell, BP, Statoil, CNPC, Eni, Inpex are possible partners
- More cooperating between Iraq and Kurdistan
  - Growing oil production

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# Russia turning to China and Turkey

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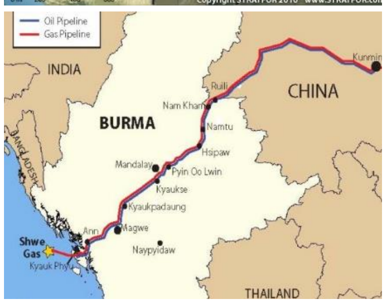
- Lower oil prices may lead to $90 billion to $100 billion in annual losses for Russia
- Sanctions are mainly hitting Arctic exploration
- Russia and China has signed major gas agreements
  - Value some $400 billion
- New gas pipelines will connect Russian gas to China
- Rosneft has become China’s main oil suppliers after Saudi Aramco - rapid growth in sale to Beijing
- Russia has turned to Turkey for gas partnership
  - Dropped the South Stream gas project
- “Turkish Stream” may strengthen the role of Turkey as a transit country

# China: More gas - less oil demand



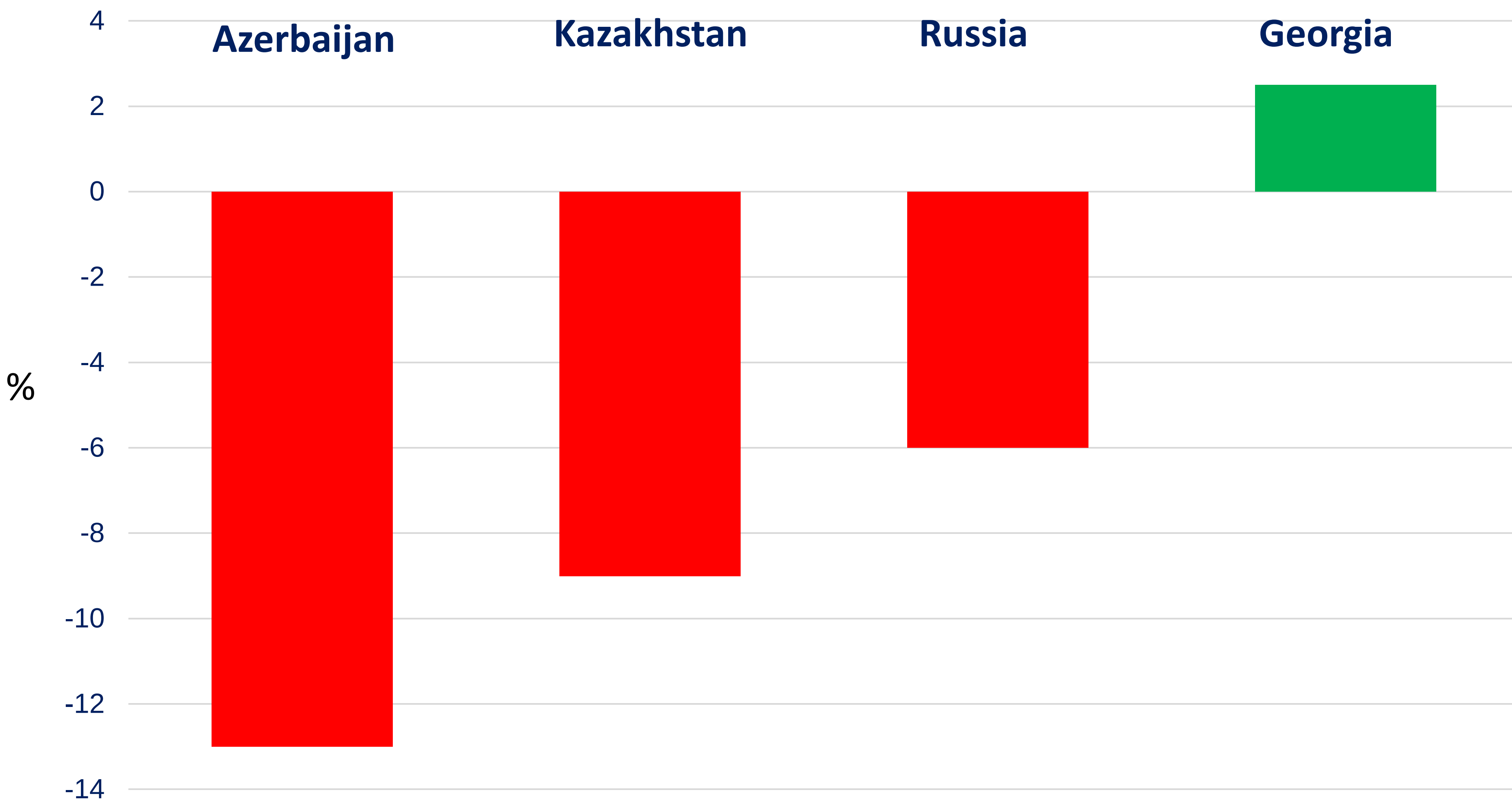


- China has accounted for about 35% of growth in global oil demand in recent years
  - May now slow down to less than 300,000 b/d
  - About half of the demand growth in the last six years
- The government's main focus will be on restructuring the economy away from export led growth
- Contributing to the slowdown in oil demand growth
- China has an ambitious climate change agenda
  - Energy efficiency
  - Development of clean energy
- Natural gas will grow in importance as a more climate friendly energy source
  - Gas pipelines to Turkmenistan, Russia and Myanmar
  - Major import terminals for LNG

# Major decline in export revenues

- Oil and gas represent a large share of the total exports from Russia, Kazakhstan and Azerbaijan
- Value of their oil exports were in 2014 estimated at
  - US$163 billion in Russia
  - US$54 billion in Kazakhstan
  - US$26 billion in Azerbaijan
- Natural gas and petroleum products are also a significant part of the export basket
  - Gas account for a further 6% of exports in Azerbaijan
  - Petroleum products and gas exports for 6% in Kazakhstan
  - Gas and petroleum products - 34% of Russia's total exports

# Losses and gains from $50 oil price




IMF staff calculations.

# Kazakhstan – reducing its oil price outlook

President Nursultan Nazarbayev

- Kazakhstan's oil industry is often referred to as the "locomotive" of the national economy.
- Not facing a financial crisis
- The president ordered the government to allocate $3 billion from the National Fund every year from 2015 to 2017 to bolster growth in an economy hit by falling oil prices and a slowdown in Russia.
- The national currency reserves are over $100 billion
- The $77 billion oil fund is been used to maintain the value of the Tenge, rather than devaluate the currency
- Gradual devaluation if the oil price stays below $50
  - The national budget was first based on US $90 per barrel
  - Reduced the assumption to $80/barrel and now to $60/barrel

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# An economic locomotive in Kazakhstan

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Vladimir Shkolnik
Kazakh
Energy minister

- Kazakhstan has three huge oil and gas field dominating the sector
- Tengiz and Karachaganak account for around half of the 1.7 million b/d liquids production
- The huge Kashagan field is closed down – restart in 2016?
- Oil and gas represents about half of the government’s total revenues and 45% of foreign exchange earnings
- 60% of the work in the manufacturing sector are linked to the hydrocarbon sector of the economy
- Low oil prices may force many manufacturing firms to reduce their workforce since contracts may be on hold

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# Turkmenistan - huge gas resources

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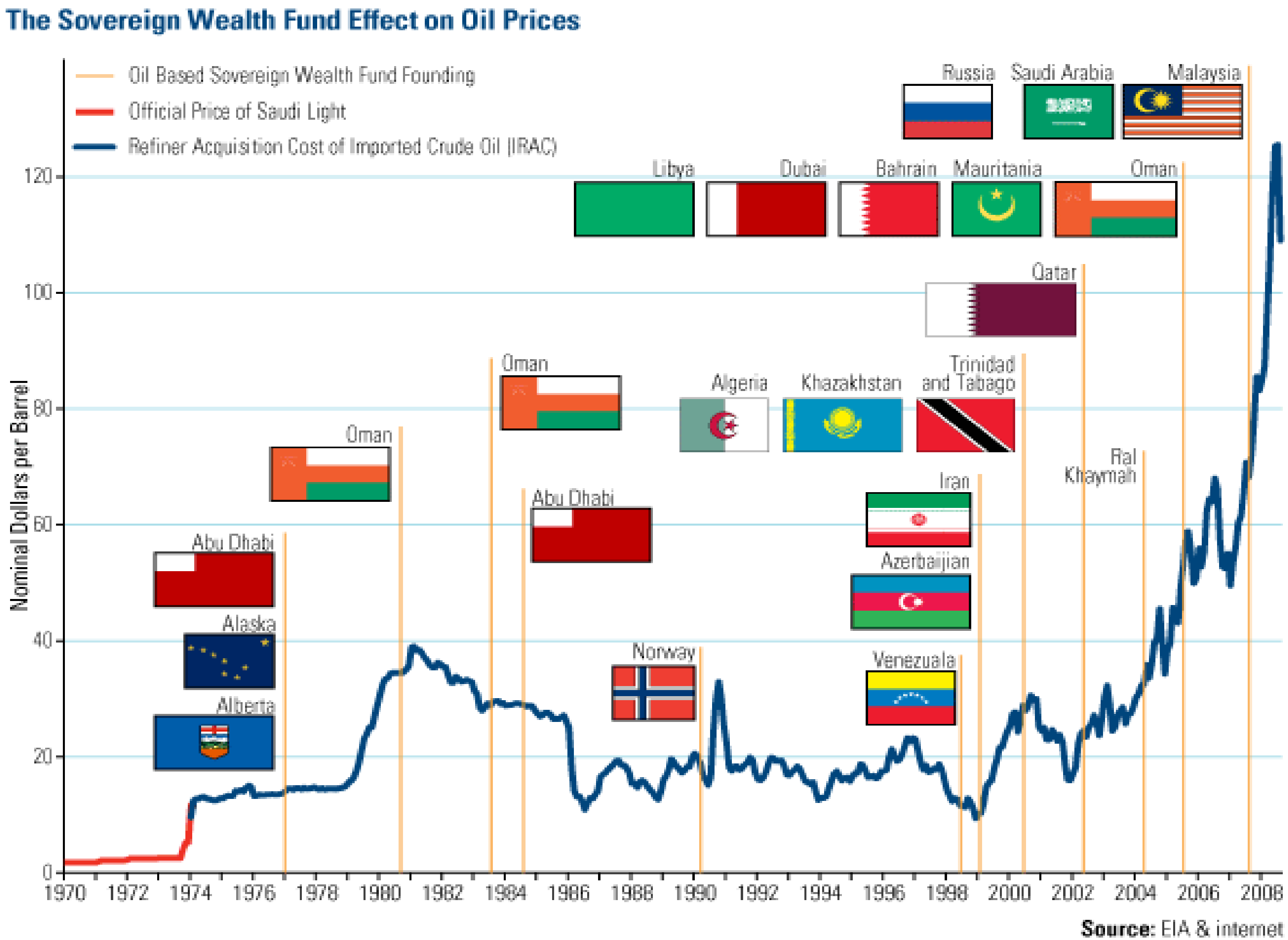
Turkmenistan–Afghanistan–Pakistan–India pipeline has been under discussions for 20 years

- Turkmenistan has large natural gas reserves
- Expecting major growth in gas production
- Natural gas production may to reach 103.3bcm per annum by 2018
- An average growth rate of 6.8% per annum.
- The country's rising potential is supporting a significant strengthening of ties with China
- China plans is to be importing 65 billion cubic metres of gas from Turkmenistan annually
- Building a fourth branch of the China-Central Asia pipeline to provide 40% of gas imports by 2020

# SWFs and Oil Price



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# SWFs – Not a Homogenous Group

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- Stabilization Funds – Insulate Budget/Economy (e.g. Chile, Kazakhstan, Azerbaijan, Algeria and Venezuela)
- Saving Funds – Intergenerational Transfer (e.g. Kuwait, Qatar, U.S. Alaska)
- Reserve Investment Corporations – Part of Reserves; Increasing Returns (e.g. Korea)
- Development Funds – Socio-Economic Objectives (Samruk-Kazyna of Kazakhstan)
- Contingent Pension Reserve Funds – Finance Unspecified Contingent Pension Liabilities of Government (Australia, New Zealand)

# … Reflecting Differences in Funding Sources

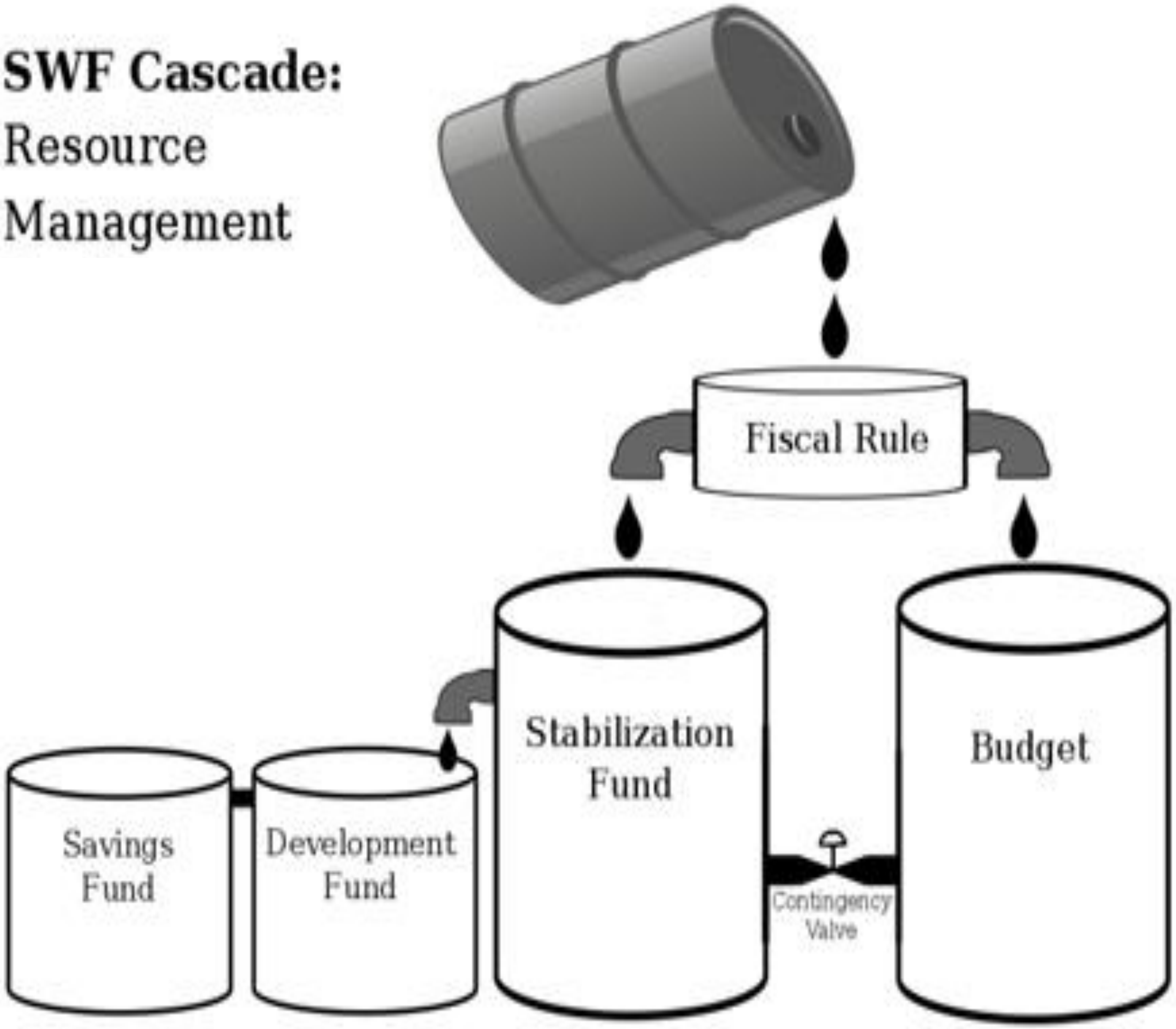
- Energy and Commodity Receipts (e.g. GCC countries, Norway, Chile, Trinidad and Tobago, Timor-Leste)
- Carve –out from Foreign Exchange Reserves (e.g. China, Korea)
- Other Means of Financing (e.g. Australia, New Zealand)

# Oil funds can offset reduced revenues




- Azerbaijan and Kazakhstan transfer the lion's share of the fiscal revenue from the oil and gas sector into an "oil fund"
- Sovereign wealth funds to offset revenue shortfalls due to a major fall in the oil price
- Kazakhstan's fund was set up in 2000 as a stabilization fund
- Transfers from the oil fund to the national budget likely to be higher now than in a $100/barrel environment
- The countries can – if required - use the assets in the oil fund to bolster the economy
- Global sovereign funds are expected to react differently to the new environment.
- A few may become more conservative in investment decision

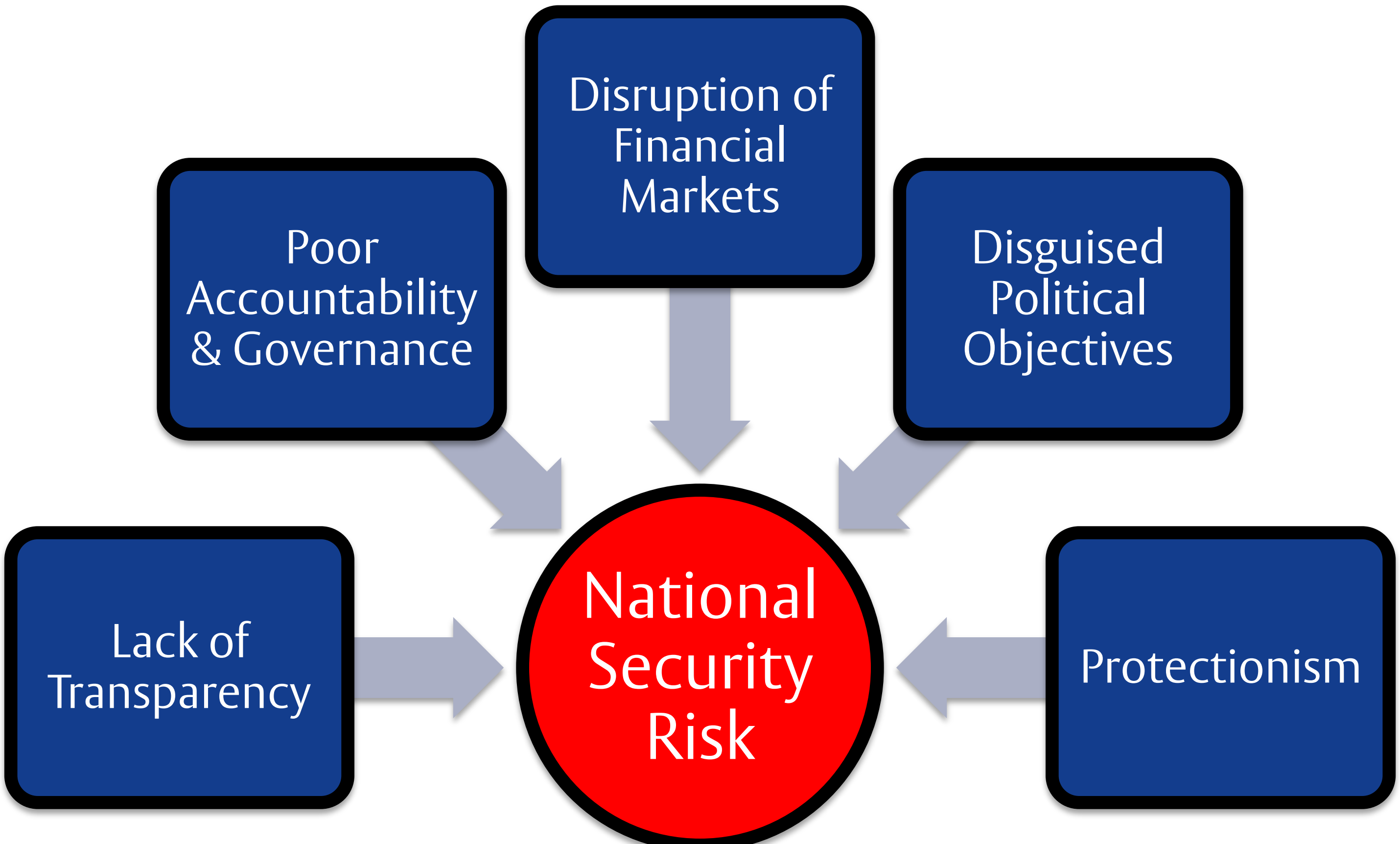
**SWF Cascade:**
Resource
Management



# Main Issues

- SWFs control about $3 trillion in assets up from $500 million in 1990, and they are expected to grow to $12 trillion by the end of 2015. (IMF)
- Most of them are based in the Middle East and Asia.
- Because of their growing size SWFs have become a major focus of national and international economic and financial policy with issues such as:
    - their lack of transparency
    - their potential to disrupt financial markets and to compete unfairly with private investors
    - the risk that political objectives might influence their management.

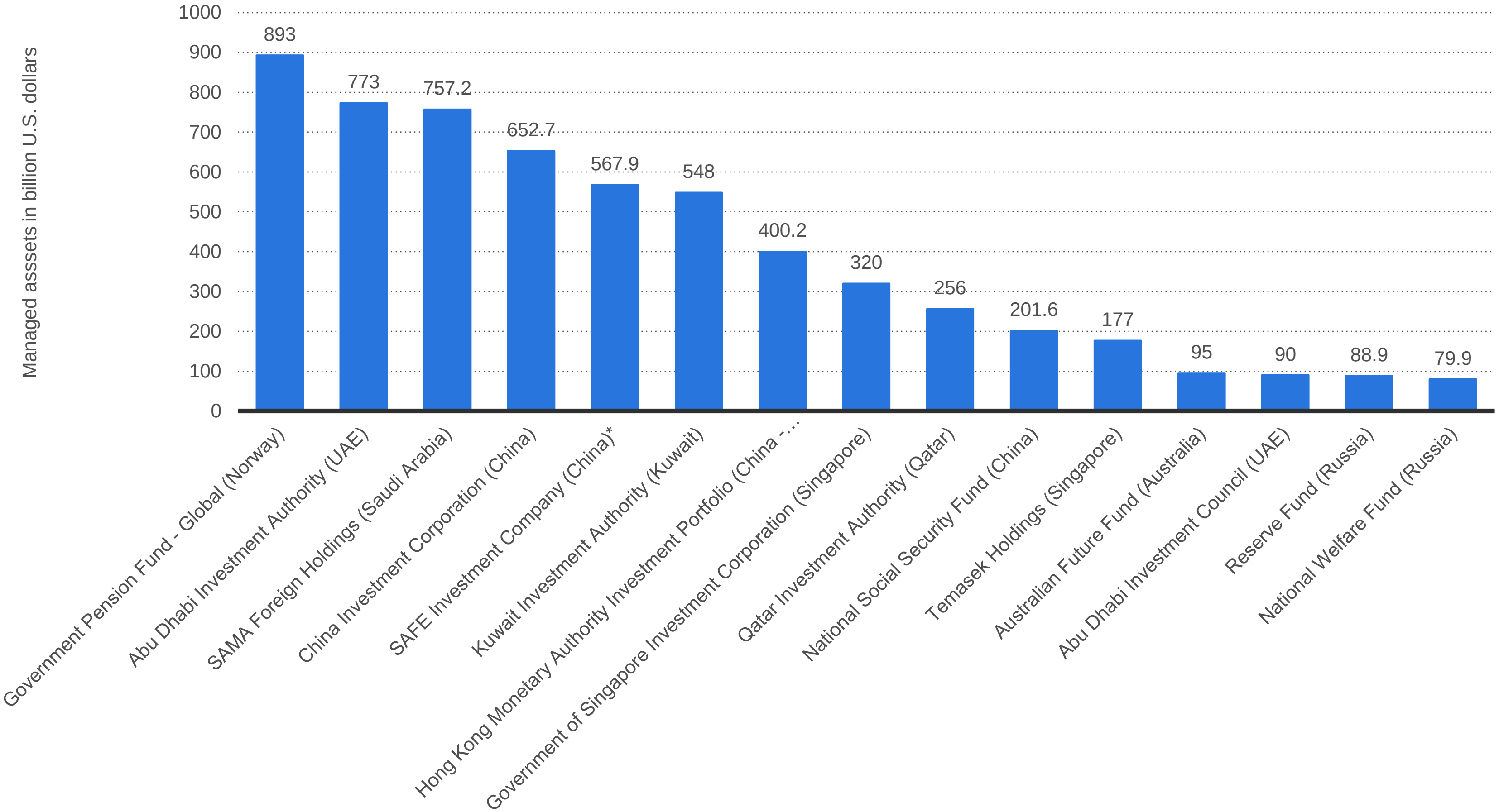
# The Issue: National Security



# Largest sovereign wealth funds worldwide as of December 2014, by assets under management (in billion U.S. dollars)





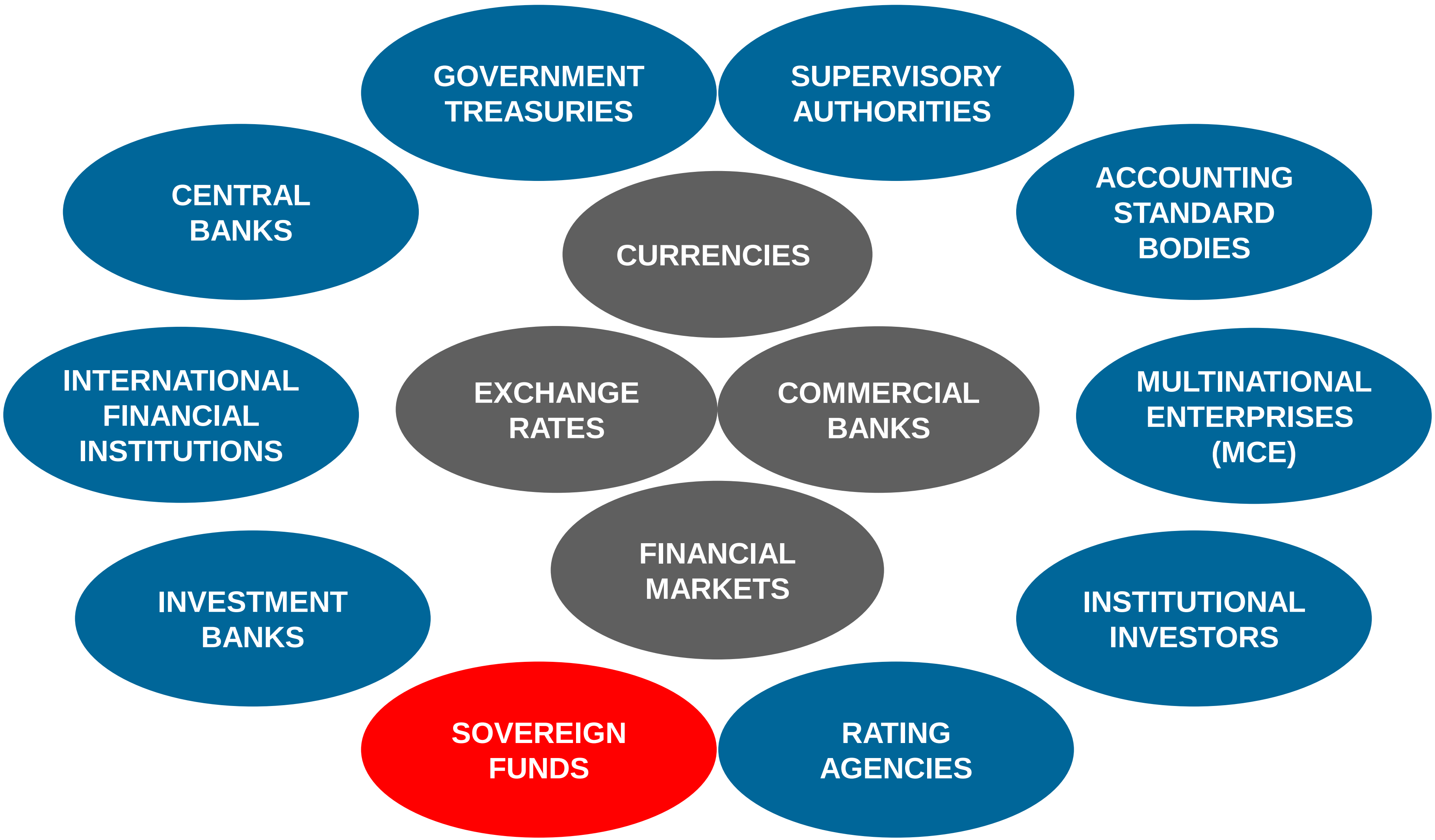



**Note:** Worldwide; as of December 2014

Further information regarding this statistic can be found on page 8.

**Source:** SWF Institute; ID 276617

# SWFs are key players in Global Financial Markets



# Oil Prices Push SWFs Toward Alternative Investments

- A number of SWFs dependent on oil have been facing up to the twin threats of declining traditional asset values and flatlining oil prices, leading many of them to realize that the time to consider alternative investments might be here.

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# Instead of the conclusion: *What future holds?*

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- There have been challenges in getting out of traditional assets.
- SWFs continue to struggle to find major direct-investment opportunities.

- But if oil futures continue to slide, SWFs should either regain their direct- investment footing or look for other investments quickly.

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# … and finally five final observations

1. **Industry confidence shaken as oil prices decline**
   28% remain confident about the industry - down from 88% in 2014
2. **More innovative approaches to cost control**
   Industry is looking for creative ways to save money, including use of new technologies, but getting rid of people is still first step
3. **Investment is on a tighter rein**
   12% are planning to increase capital investment - against 63% before the crisis began
4. **Finding new talent is no long a top industry priority**
   Near 50% may reduce headcount - less worry about skills shortages
5. But profit-confident firms can work beyond the oil-price cycle
   Most national oil companies are struggling like others