Oil and Gas Industry Overview: Naturally Resourceful

A LOOK AT THE TOP ISSUES FACING THE OIL AND GAS SECTOR

By Anthony Mahon, Deloitte Caspian Energy & Resources Leader

Current oil price fluctuations unlikely to impact global industry trajectory, according to Deloitte report

Continuing economic uncertainty, leading to a reduction in demand for oil and gas resources from the world’s second largest economy, continues to send shockwaves reverberating through the industry. The changing supply dynamics introduced by unconventional, the geopolitical issues affecting certain key producer and consumer jurisdictions and the combined downward pressures on pricing currently provides a prevailing backdrop of industry uncertainty.

The cyclicality of the oil and gas industry is, however, unlikely to impact the long term global trajectory of the sector.

Nevertheless, the fluctuations presently being experienced may speed up certain trends that were already unfolding according to Deloitte’s 2015 Oil and Gas Reality Check report.

This report outlines six the major issues currently impacting the oil and gas industry (and the upstream market in particular).

These issues include an anticipated shift in supply-demand fundamentals, the emergence of new trading patterns, consideration of OPEC’s role in the market, falling LNG prices, the long-term costs of complex projects and evolving dynamics between integrated oil companies (IOCs) and national oil companies (NOCs).

The report highlights the following key trends:

SHIFT IN SUPPLY-DEMAND FUNDAMENTALS

Fluctuating industry dynamics are fueling a power play between traditional and new oil suppliers.

For example, the United States continues to maintain its place as a major producer of both oil and gas, while historical energy trade patterns are shifting.

With the loss of the United States as an anchor market, the world’s major oil suppliers are searching for new buyers.

NEW TRADING PATTERNS EMERGING

As oil and gas supply and demand fundamentals continue to evolve, new global trade patterns are emerging. As a result, this could threaten OPEC’s traditional position on global markets, although this is not a likely outcome in the short-term.

What is certain is that OPEC will be seeking new buyers as North America increasingly meets its own demand, and it may aim to pick up market share from Western Europe.

OPEC: UNDER PRESSURE

The OPEC organization currently supplies approximately 32% of the world’s crude oil. However, OPEC’s oil market share will fall by 5% by 2018 as the supply of US tight oil picks up.

While that share may recover over the long term as supply patterns shift (particularly if US production flattens), OPEC will cede power in the interim.

To prevent this slow erosion, IOCs will need to guard against the instinct to engage in mass layoffs while commodity prices remain soft. While there is always room for heightened cost consciousness, IOCs may want to avoid putting themselves into a position where they lack the talent and momentum they need not only to ramp production back up once prices recover, but to maintain their edge in a shifting competitive landscape.

These issues facing the global industry impact upon the oil and gas industry in Kazakhstan to varying degrees. They should, however, also be considered alongside certain issues either specific to Kazakhstan or which are likely to have a more keenly felt impact upon the industry and its participants in Kazakhstan.

Downward cost pressures and relative capital scarcity amongst both super majors and more junior producers means that it is more crucial than ever for Kazakhstan to position itself as an attractive destination for such capital to be invested.

This means not just the general provision of a climate that enables investment but one where returns on capital can reach necessary levels such that investment decisions to direct capital to Kazakhstan rather than alternative projects and jurisdictions are facilitated.

Such improved returns on investment could be secured via a reform of the fiscal regime applicable to subsoil users and new projects. This reform continues to be campaigned for by producers, industry associations and professional advisors alike. However there is, yet, no sign that Republican authorities are currently willing to engage in any constructive dialogue in this regard.

Furthermore, certain elements of potential fiscal reform (such as a mooted replacement of VAT with a sales tax regime) which could increase the cost base of Kazakhstan-based producers will only serve so as to diminish available returns on capital and render Kazakhstan less attractive as a destination for oil and gas investments.

Today’s oil and gas landscape is one where increasing numbers of alternative supply sources and investment opportunities compete for both limited demand and investment. Insofar as major further sources of supply (such as a sanction-relieved Iran) were to come fully into the competitive landscape then the ferocity of competition would only increase.

Accordingly, it is imperative that oil and gas industry in 2015.

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