Fifty Shades of Black

Summary of the Annual Discussions of the Windsor Energy Group
6-8 March 2015, Windsor Castle

The 13th annual WEG meeting at Windsor Castle addressed the global challenges facing energy companies and governments at a time of low oil prices and growing political uncertainty.

Key Factors Affecting Energy Prices

- This international expert gathering indicated that, with a large surplus of energy, high stock-levels and weak demand, energy prices may well stay depressed for at least three years. This projection would of course be invalidated by any major interruption in the supply of internationally traded oil, gas or coal.
- Upstream investment, shale projects and low-carbon energy projects are being shelved as a consequence.
- Governments from energy-producing countries face difficult choices as their energy revenues fall. Many governments have budgets based on $100 per barrel. As a consequence, some countries are ill-prepared to face new and growing political, economic and social uncertainties.
- Equally, among the OECD governments, many are finding the cost of low-carbon subsidies and rising underpinning of alternative energy too expensive.
- The coming year will see financial uncertainty as shale exposure in junk bonds comes apparent. These loss-making contracts are said to amount to 20 per cent of U.S. junk bonds. U.S. shale producers in the U.S. have continued producing at a loss in the hope of consolidation.
- The wildcat nature of U.S. shale combined with improvements in extraction means that U.S. shale production will respond quickly to any sudden upward movements in oil prices.
- The immediate outlook is therefore for a big increase in global energy debt, large budget deficits by many governments reliant on energy revenue and some major restructuring of the energy industry as consolidation takes place.

The Big Picture--Energy Demand and Future Cost

Within much of the OECD world, low growth, confused markets and energy paradoxes have tended to erode confidence in future economic prosperity. Yet non-OECD countries now account for 58% of global primary energy demand. A continued increase in their global share, barring severe global depression or major interruptions to supply, worldwide, is more or less assured while oil prices remain well below $80. Nonetheless the recent steep fall in non-OECD oil import costs is likely to release budgetary and private sector funds to accelerate economic activity and thereby increase their imports of oil, coal and gas. Unexpected boosts to supply have also already produced much new economic activity in the U.S., re-ignited exploration planning in Australia and produced rising coal imports in Germany.

Few participants expect current market conditions to persist for more than five years. As the industry draws in its horns and global investment in new sources of energy supply begins to dry up, there will be intense pressure on Saudi Arabia. Supported by other OPEC members and many non-OPEC exporters and much of the international oil industry, the Saudis may well be tempted to reverse their current policies that are aimed at retaining market share at the cost of coping with severe cuts in export revenue. Another major oil price explosion within this period is therefore beginning to look increasingly possible.

Oil and Energy Wars--The Quick and the Dead

The collapse of oil prices is already bringing major change in how global energy markets operate. Gas contracts linked to oil prices are being re-written. High-cost and high-risk upstream projects are being shelved. Rig-counts have shrunk; rig rates slashed; energy jobs are shrinking; more political turmoil has emerged in many regions; new risks of piracy and a new fear of other military interference on the main supply-routes; cyber-hacking – major companies have found that hackers can pose a real threat. Out of this confused reaction to the oil price fall, the most puzzling is the Russian response.

The Russian Factor

Russia has issued barely veiled threats to curtail exports of gas and oil to any state that steps too far out of line in failing to comply with the Kremlin's directions. Russia's leaders seem to believe that the collapse of the oil price was part of a deliberate conspiracy to undermine, weaken and ultimately secure the collapse of the Russian economy. Given a different reading of the situation, this may be no more than part and parcel of international diplomatic exchanges, although both sides seem to be increasingly aware of the dangers of escalating local conflagrations and the (still remote) risks of blundering blindly into World War Three.

An About Turn on Climate Change

Within the last five years the pendulum of scientific opinion has swung back to pointing out the dire consequences of increased pollution of the atmosphere. Between 1990 to 2035 greenhouse gases, notably carbon dioxide trapped in the atmosphere, are now expected to double. The consequences are likely to be catastrophic – most notably within 35 to 50 years - a possible breaking down of the Gulf Stream and a disruption of the monsoons, each having severe and chaotic impacts on global agriculture, food supply, access to fresh water and heavy damage to agriculture and fisheries. Meanwhile, the principal remedies of Carbon Capture and Storage remain at the prototype stage and still very far from profitable commercial exploitation worldwide.

Turmoil in the Middle East

Detailed reports by our "front-line" WEG specialists focussed on Iraq, Syria, Saudi Arabia and Libya. The latest news of atrocity, hardship and misery for refugee and displaced minorities is particularly grim. A special session devoted to ISIS assumed a continued spread of terrorist attacks both within the Middle East and elsewhere.

The Sunnis led by Saudi Arabia have come under pressure and challenge not only from Iran but also their own Shia communities. Although ISIS has long-standing and deep anti-Western roots it enjoys popularity among many younger Moslem expatriate groupings worldwide. These may prove very difficult to control by tighter supervision of the internet.

In our Windsor Consultations, the optimists suggested that, in the light of past experience, it might take about ten years before ISIS could be infiltrated and broken down. The pessimists pointed to the high level of unemployment of Moslem youth in Western states and the acute frustration and disappointment that this has engendered.

By creating their so-called "caliphate", ISIS has also provided a new threat to the Arab monarchies. ISIS believes that a successful confrontation with Western forces in Syria could complete a prophecy leading to ultimate triumph for Shia over Sunni Islam. There is, however, little will in the West to become embroiled on the ground in Syria.

Ukraine, Crimea, Caucasus and Central Asia

A strong case was made for the legitimacy of Russia in attempting to protect its military assets in Crimea and to reassert its influence on the states of the Former Soviet Union. Within this energy sector, many of Russia's ties and trading systems are still intact. Relations, however, have been strained by aspirations of several states to construct new gas and oil lines to supply oil and gas direct to Europe and China in overt competition with the new Russian oil and gas export pipelines. Meanwhile the central Asian states are struggling to cope with high levels of unemployment, high inflation, increasing social tension, political in-fighting and rising internal terrorism. Meanwhile Russian overtures to Iran seem to be delivering a clutch of new nuclear and energy supply contracts and the future possibility of wider political alignment with China based on a joint energy accord.

Power Games in Asia

All the South East Asia states have become watchful of increasing Chinese challenges in the South China Sea. Almost all can see no end to their thirst for imported oil, gas and coal. North Korea's claims that its new nuclear missiles can reach California has rattled the dovecotes. The discussion concluded that South East Asia was slipping into angry rivalry and self-generated nationalism. In global terms, the move in China for population restraint to be relaxed from one to two children per family could result in a doubling of the Chinese population within less than 50 years. This will bring enormous pressures on the Chinese government that already struggles to cope with its existing population and increased demand for imported energy and minerals. Severe air pollution is affecting the economy and the Chinese are pursuing tougher measures on emissions as a practical necessity. China is a reluctant dragon facing a perfect storm.

U.S. Energy Policy

President Obama's green agenda, now assisted by the fuel substitution of gas for coal, was dissected in detail. Credit was given for the tougher efficiency standards for cars and trucks, for the closure of old coal-fired power plants and for not interfering with the speed of the new shale developments. Ironically U.S. coal is now being exported to Europe adding to the EU's carbon footprint. Cheap shale exports are not however likely to become a reality and if exports do take place they will head to the Pacific Rim.

Other Sessions

Other separate sessions were devoted to:

- The new threats of cyber warfare. Both upstream and downsteam energy operations are at risk of cyber-attack. Aramco has already suffered a serious attack. Companies and governments are therefore working on countermeasures.
- The growing role of Turkey as regional energy arbiter offering an energy corridor. Internal energy demand remains strong and Turkey is therefore going ahead with a Russian-built nuclear power station.
- Science and new technology has an important role to play. Already shale drilling is much faster and effective. The golden grail is to find affordable carbon capture and storage. Even more important is new end-use technology indicating a doubling of energy end-use efficiency within 20 years.
- The Baltic states remain heavily dependent on Russian gas, although a new floating LNG platform in Lithuania offers regional diversity of supply from Norwegian feedstock.
- The Multinationals – "the survival of the fittest". As energy debt grows there is expected to be a growth in merger and acquisition as the energy sector contracts.
- Lean times for governments in energy-producing countries as they milk ever thinner cash-cows. Several governments face growing deficits and potential instability where subsidies have to be withdrawn or cut.
- A Nuclear Re-think–China, India and the Middle East are committed to large-scale nuclear power. However smaller nuclear plants are now offering greater flexibility, lower capital costs and improved efficiency.
- Brazil remains committed to its major offshore developments although Petrobras is in turmoil, leaving the company with the biggest corporate debt in the world. Venezuela is undergoing a major crisis with the economy in a mess. Trinidad with major gas potential may become the Qatar of the Caribbean, if not of the Americas.
- Australia has a number of high cost gas projects under development. Ambitious plans for more energy production are being shelved at present due to low energy prices.
- The Arctic is experiencing record amounts of shipping and continues to attract companies and governments interested in the region's vast energy reserves.
- Lord Deben, who chairs the UK independent committee on climate change, described how green energy would continue to grow as economies of scale came to bear.
- The swamping of EU economic, energy and environmental priorities caused by the German and Swedish decisions to phase out nuclear energy and by the German decisions to import large volumes of U.S. coal.

Ian Walker/Paul Tempest

Participants in the discussions included:

***London Ambassadors*: A**lgeria, Bahrain, Cameroon, Hungary, India, Japan, Jordan, Kazakhstan, Kuwait, Latvia, Poland, Qatar, Russia, Turkey.
***Lead Speakers/Chairs*:** Lord Howell, HE Khaled Al-Duwaisan, Lord Deben, James Clad, Lady Judge, Spencer Dale, Dr Herman Franssen, Prof Bill Arnold.
***Major Companies*:** Aegis, BP, Bosphorous, Chevron, Christal, Dow, Elion, Exxon-Mobil, Hitachi, Jogmec, Petrofac, Shell, Worley Parsons.