2016: Friend or Foe in Face of Global Oil Pricing Crisis?

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2015 saw the global oil and gas market in turmoil and 2016 looks set to continue the trend.

16 January 2016 saw the lifting of sanctions against ***Iran***, and critically signified its re-entry as a major ***OPEC*** player to the already saturated global oil and gas market. With the world's fourth-biggest oil reserves, an immediate increase equivalent to an extra 500,000 barrels a day is predicted, increasing over the year to meet pre-sanction levels by the end of 2016. This would represent approximately 10% of total OPEC production and is only forecast to increase.

President Rouhani has wasted no time in ensuring that the global markets are in little doubt that Iran is, in his words "open for business" visiting Italy and France within a week of sanctions being lifted, the first such European Tour by an Iranian premier in two decades. Europe has not disappointed with companies such as Airbus and Peugeot clamouring to take advantage of Iran's $400-billion economy and 80 million consumers. Notably, President Rouhani has been accompanied by his Oil Minister, Bijan Zangeneh, who had already met with French energy company Total and Italian oil and gas supplier ENI in Tehran before departing on the current trade tour. This has been quickly followed by announcements that Japan will be extending its contract with Iran for the purchase of crude oil and that Russian oil company Lukoil have signed a deal to facilitate oil exploration in Khouzestan. Italy was formerly Iran's biggest European trading partner, so its enthusiasm was to be expected, but it would appear that early signs are that Iran has been welcomed back to the global stage with open arms.

The lifting of the sanctions on Iran has occurred at a time when the oil and gas industry is already experiencing unprecedented volatility and pricing pressure at a global level. This has coincided with a global fall in demand driven by increased fuel efficiency and a weaker European economy. With the Asian markets also showing worrying signs, could 2016 see prices dip to the $7 per barrel low seen in the mid 80's? This was the unsettling prognosis floated by BP's chief executive Bob Dudley at the World Economic Forum in Davos where he likened the current crisis to that of 1985/6 where prices did indeed fall that low. Current projections for 2016 are not quite so bleak with Morgan Stanley remaining relatively cautious stating that "oil in the $20s is possible", the Royal Bank of Scotland plumping for $16 and Standard Chartered giving the most pessimistic prediction of just $10 a barrel.

With the price per barrel currently sitting at $30, such a dramatic fall to the depths of $7 seems almost inconceivable but when you begin to factor in decreased demand in China, as the world's second largest consumer of oil, as a new pressure on already depressed prices, it starts to look like a less irrational assertion and we must remind ourselves of the most obvious point…. that it has happened before.

In the UK, 2015 saw an increase of 56% in oil and gas insolvencies, up from 18 in 2014 to 28. Losses were primarily felt in and around the Scottish oil and gas powerhouse of Aberdeen where the number of operational rigs fell by 52%. North Sea oil and gas job losses topped 5,000 in the last year. Last week's announcement from David Cameron that he is establishing a North Sea support group to help the ailing sector only serves to underline the depth of impact of declining oil prices in the UK, and the importance of the sector as a whole to the UK economy.

The North Sea oil fields are one of the most expensive places to produce oil and gas so it is unsurprising that they have been hit hard by the current pricing crisis. On 6 January 2016, Chad Griffin and Lisa Rickelton of FTI Consulting LLP were appointed as Joint Administrators of Iona Energy Company (UK) plc and Iona UK Huntington Limited, both oil and gas exploration and production companies with assets in the UK North Sea. In an effort to avoid following them, other companies have turned to hedging as an effective risk management tool to lock in a significant proportion of their 2016 output for between $55 and $98 a barrel.

But is the fall in the price of oil all bad news? If we look outside the producer countries and the industries directly affected by the drop in oil price, the wider picture is considerably less gloomy. It is the oil intensive industries which will benefit first such as agriculture, manufacturing, transport and aerospace. These businesses will either redirect savings on input costs to facilitate investment leading to the creation of jobs, retain surplus funds in the business increasing profit margins or pass on the savings to their consumers ultimately increasing demand for their products. All positive impacts on economic activity which have the potential to flow up and down the supply chain.

For Joe Public the impact is largely positive with rises in real household income which lead to increased spending as people take advantage of price savings at the petrol pump and beyond. Increased economic activity also generates increased tax revenues which should go some way to offsetting decreases in direct tax revenues from the oil and gas sector. The longer the price of oil remains depressed, the more pronounced these positive impacts become. Depressed oil prices should ultimately be a good thing for government, consumers and industries that are not directly involved in the supply of oil and gas.

Accurate oil price forecasting is notoriously difficult, particularly against the current backdrop of volatility in the financial markets. For now, the world is watching and waiting and it remains to be seen who will be the winners and losers in the global balancing act of oil supply and demand in 2016.

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