

# The Outlook for Physical and Paper Oil Markets in 2009

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The Pulse of Finance



# Cyclical vs. Structural

- **Market shifts beg the question: structural (long-term trend, paradigm shift) or cyclical (mean reversal)?**
- **2000-1: “new paradigm” of slowing demand growth & falling prices -- high-tech revolution, energy/GDP decoupling**
- **2003-1H2008: new new paradigm of ever-rising prices -- End of Oil (peak oil, above-ground risk), runaway demand growth (China), oil as asset class (commodity indexes, hedge funds)**
- **2H2008-?? New new new paradigm?? Demand destruction & post-oil economy, or new supply crisis in the making?**



# Die-hard bullish view

- **Price rally as structural bull market: growing wedge between runaway demand (primary driver) and increasing supply scarcity**
- **Sell-off seen as temporary, driven by cyclical economic downturn**
- **Supply concerns, for from assuaged, are reinforced by the downturn: low price + credit crunch seen as deterring needed investment in production capacity**
- **“The lower prices fall today, the higher they will rebound tomorrow”**

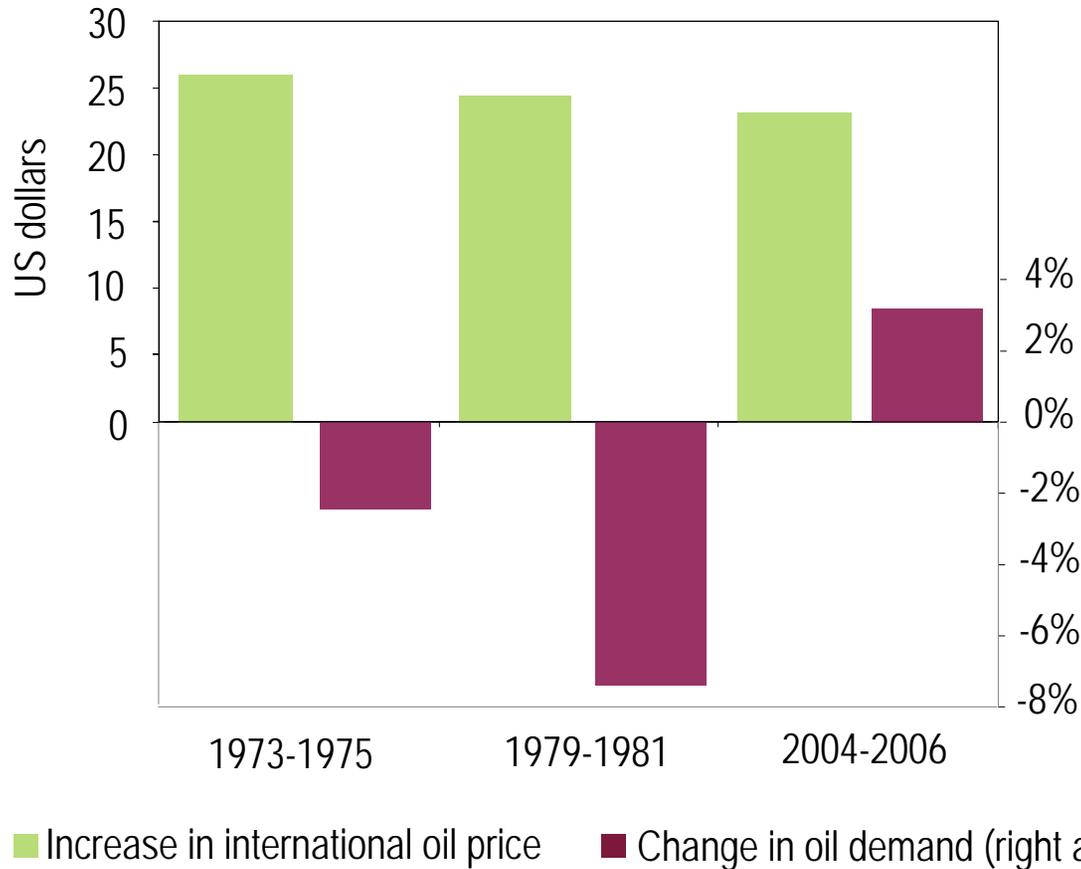


# A more likely scenario

- **Supply scarcity reflects a mix of structural and cyclical components. Above-ground risks are market-driven. The market has turned the corner on resource nationalism**
- **Current demand downturn likewise reflects a mix of structural and cyclical drivers. Some demand destruction will stick. US oil demand has peaked. Demand in emerging economies is set to slow**
- **Corn ethanol policy overhaul is overdue but fuel switching, alternative energy and cleantech are here to stay, will gain momentum**



# The myth of a demand-driven rally

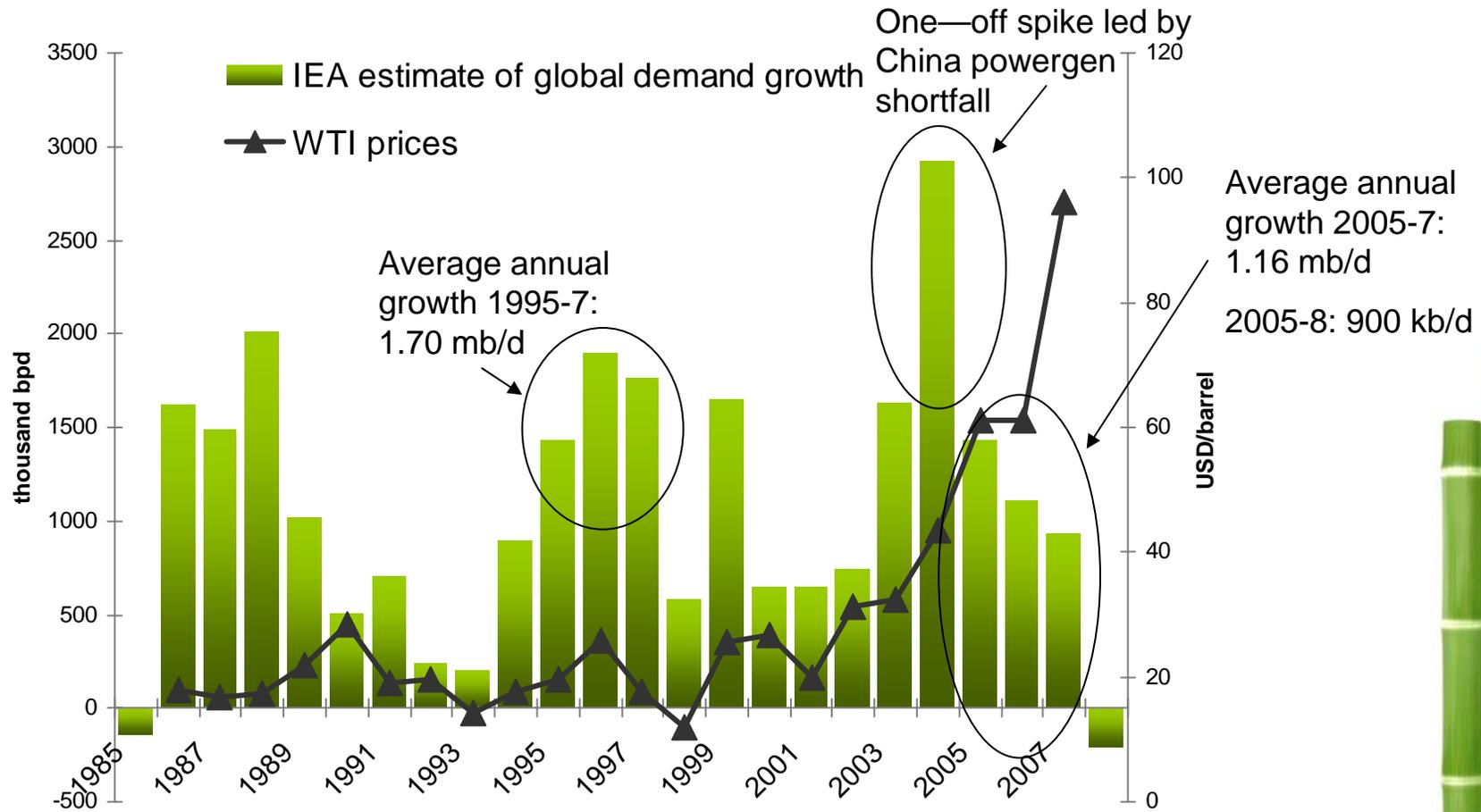


Source: IEA

**IEA: Oil demand “much less responsive” to price hikes than in the past “partly due to the impact of subsidies & diminishing scope for substitution in end uses”**



# Demand downturn didn't start with Lehman's exit

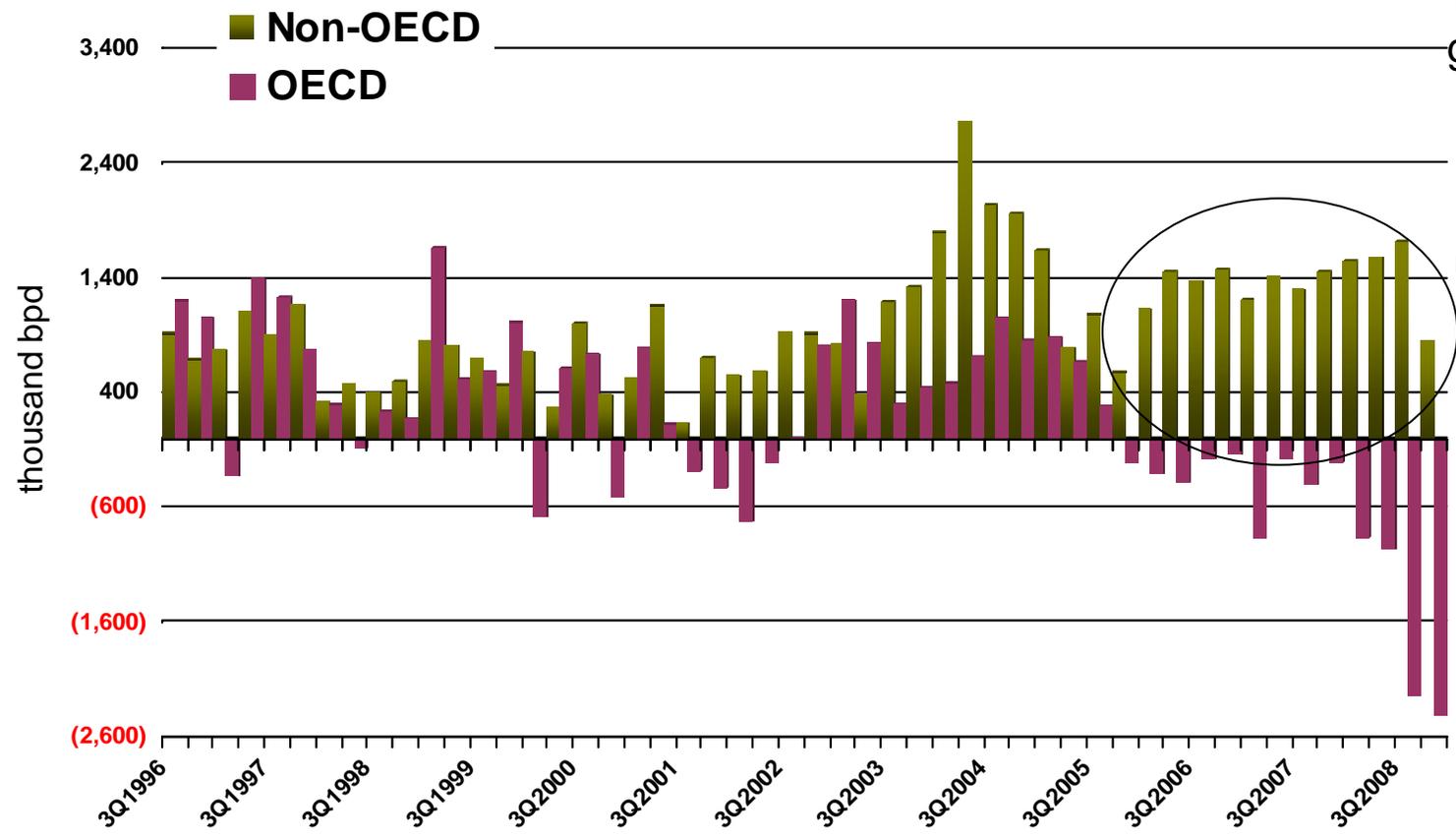


***no compelling evidence of demand growth acceleration***

# Off-shoring oil demand growth

Annual change in Non-OECD total oil demand

Source: IEA



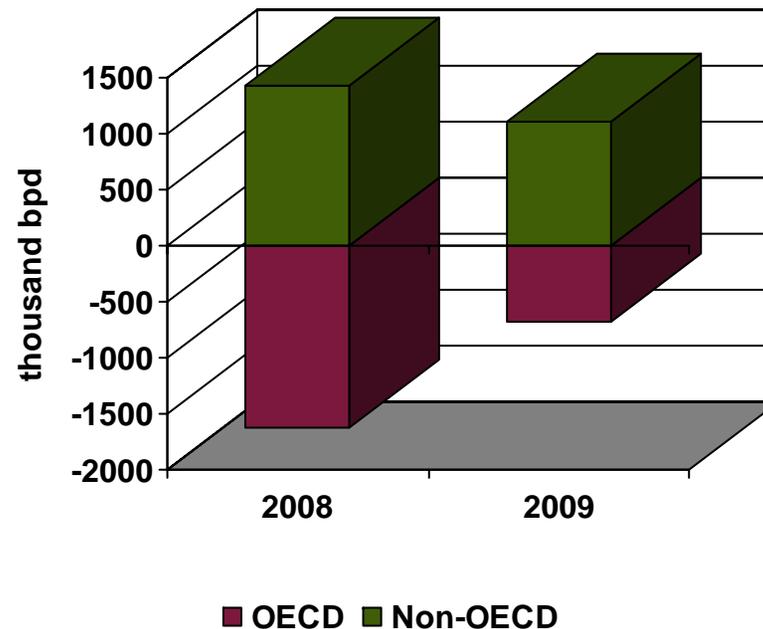
Three years of growth



# Global demand slowdown set to continue in 2009

- **IEA Dec 11, 2008 OMR cuts demand growth forecast by 350,000 bpd for 2008 and 260,000 bpd for 2009 – fourth consecutive cut** (November cut 330,000 bpd for 2008 and 670,000 bpd for 2009)
- **Current projections:**
- **World:**
  - - 202,000 bpd 2008
  - + 436,000 bpd 2009
- **OECD**
  - - 1.63 mln bpd 2008
  - - 670,000 bpd 2009
- **Non-OECD**
  - + 1.43 mln mdp 2008
  - + 1.10 mln bpd 2009

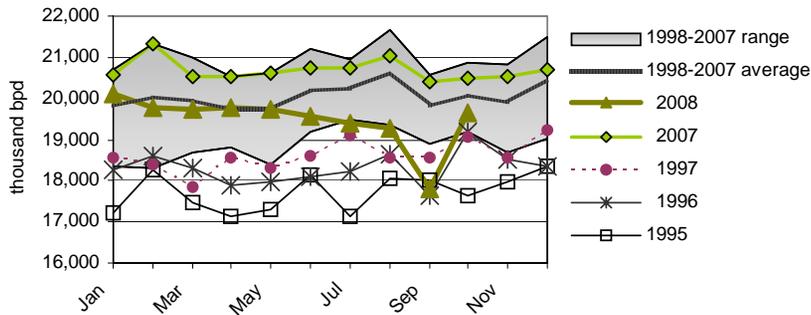
IEA Dec 11, 2008 OMR  
Oil Demand Growth Forecast



# Peak US demand – a notion gaining currency

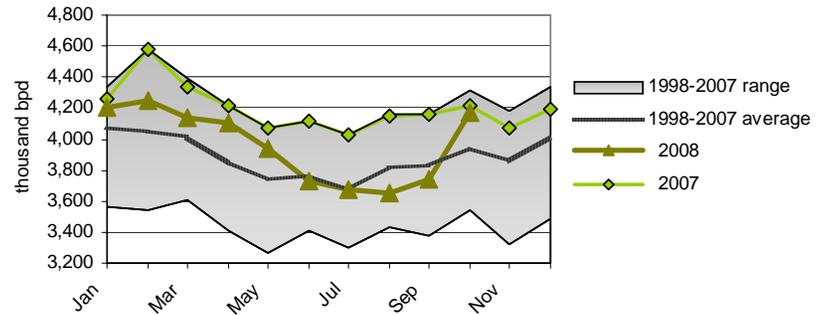
Monthly US oil demand: total products

EIA



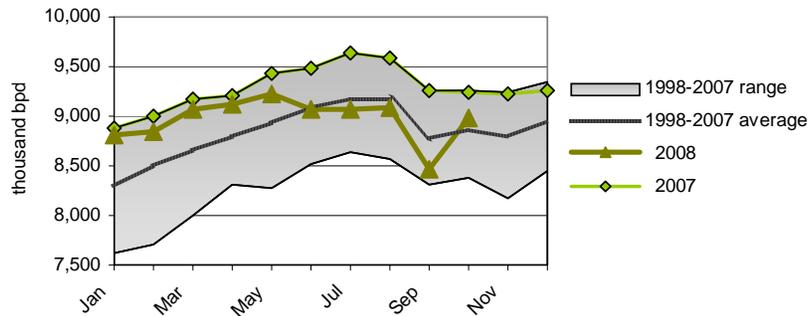
Monthly US oil demand: distillate

EIA



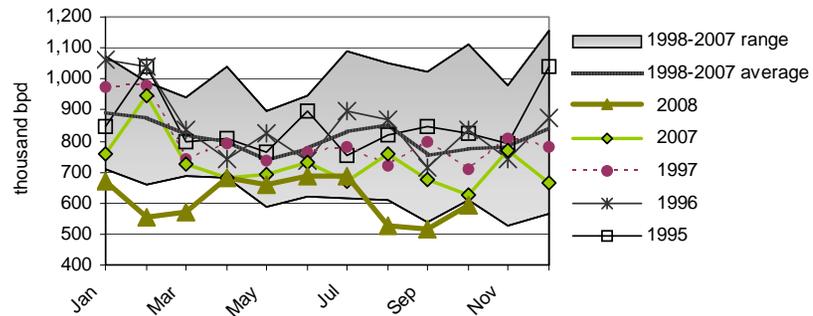
Monthly US oil demand: gasoline

EIA



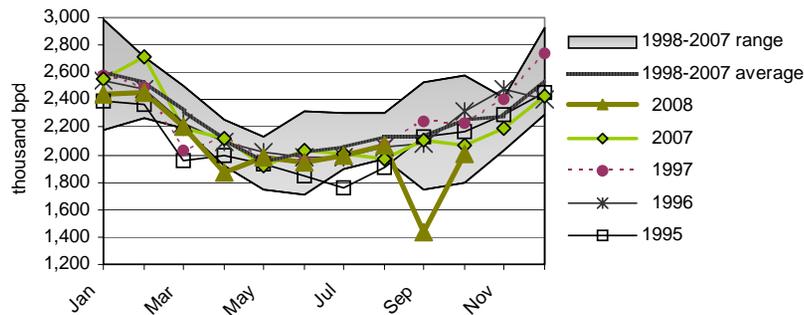
Monthly US oil demand: residual fuel oil

EIA

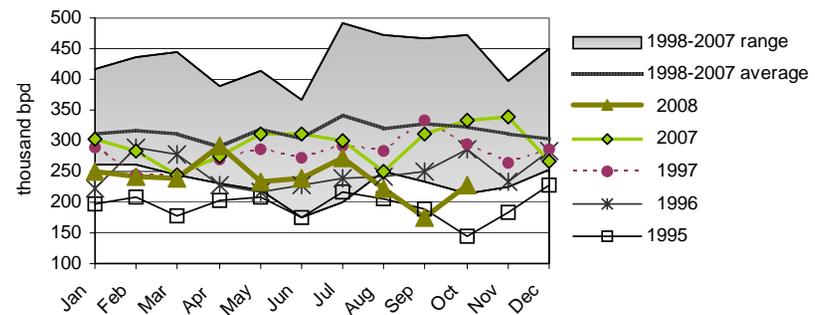


# US hurricane demand effects

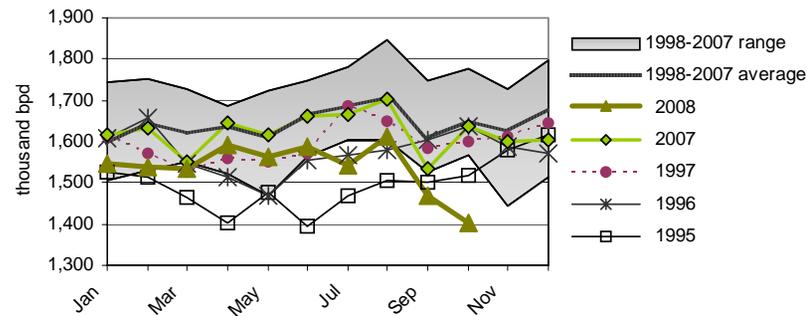
Monthly US oil demand: NGLs & LRGs  
EIA



Monthly US oil demand: petrochemical naphtha  
EIA



Monthly US oil demand: kerosene-type jet fuel  
EIA



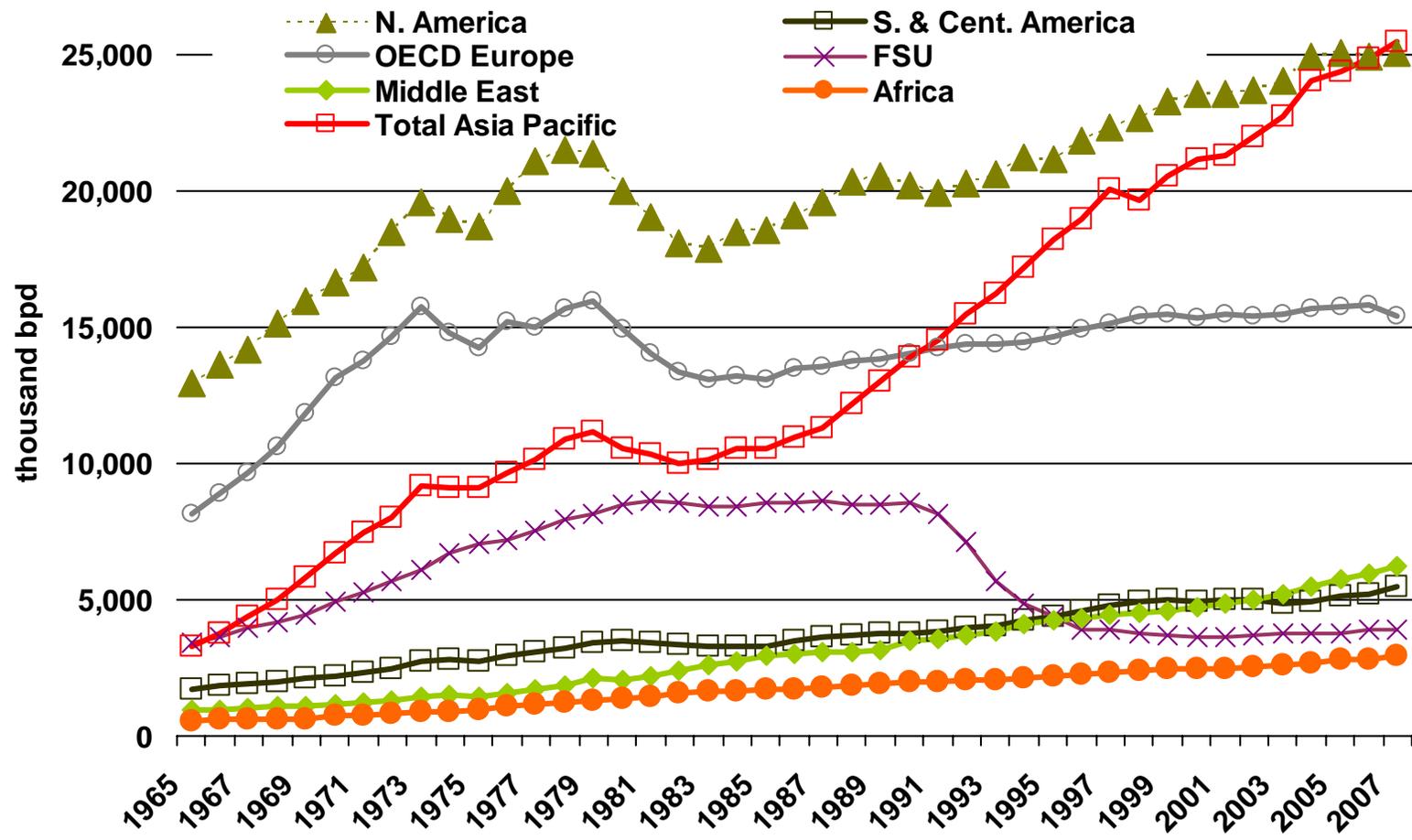
# Global demand hit set to exceed expectations

- **Economic forecasts downplay downturns**
- **Myth of US-China decoupling**
- **Vanishing US consumer's shoes way to big to fill**
- **Chinese demand outlook weaker than expected**
- **Destruction not suppression**



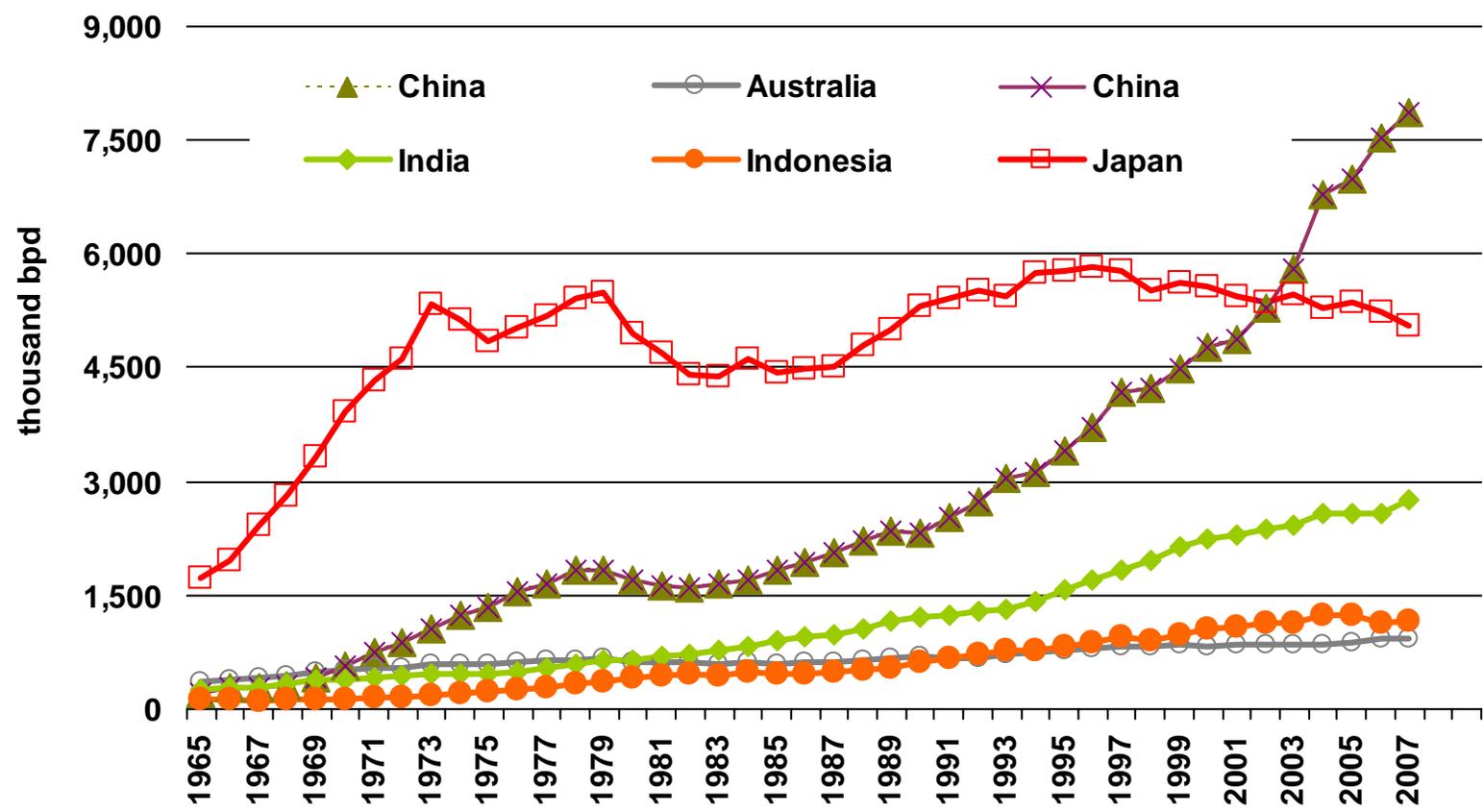
# Demand contraction past & present: Europe

BP Statistical Yearbook 2008



# present: Japan BP Statistical Yearbook

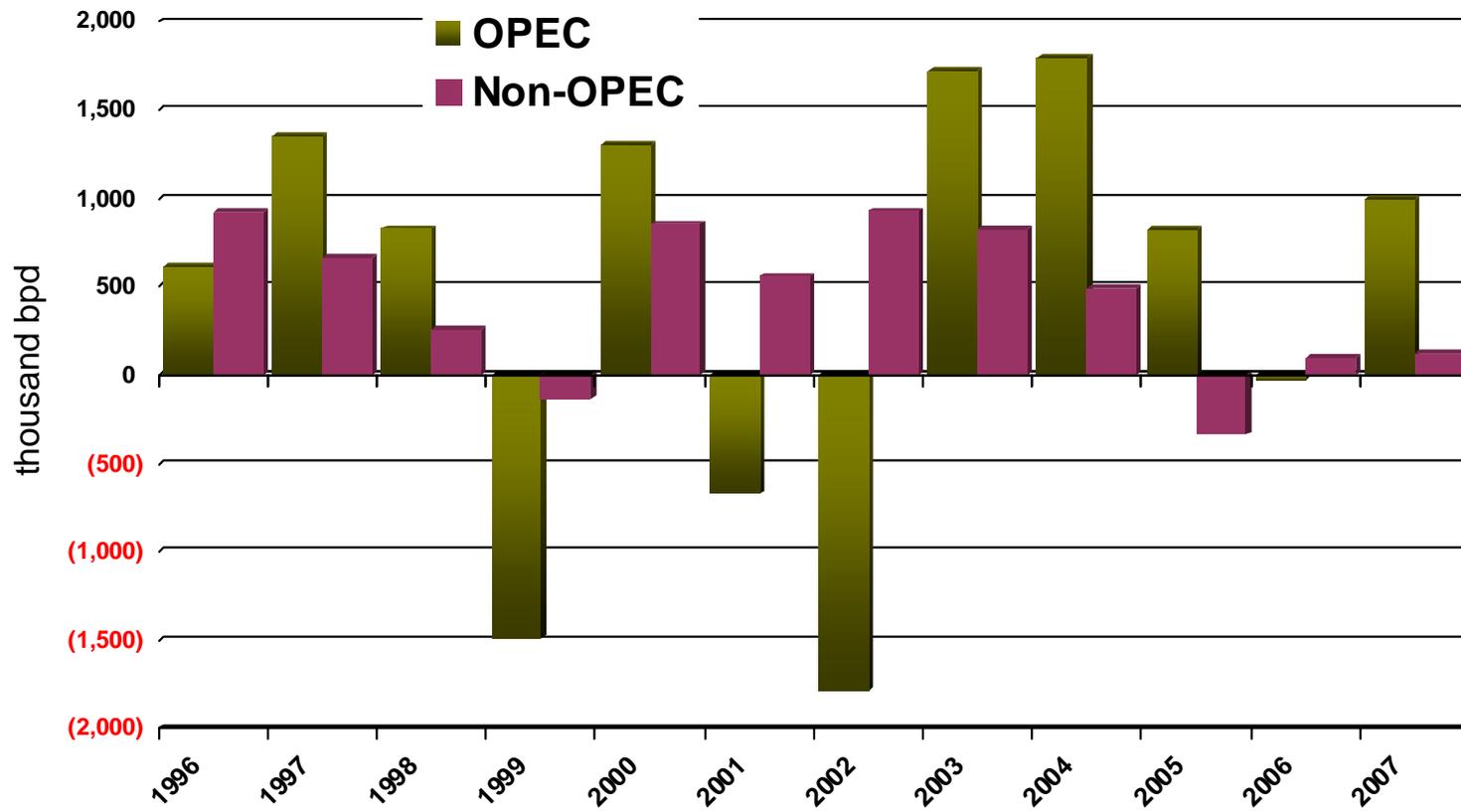
2008



# Supply drivers

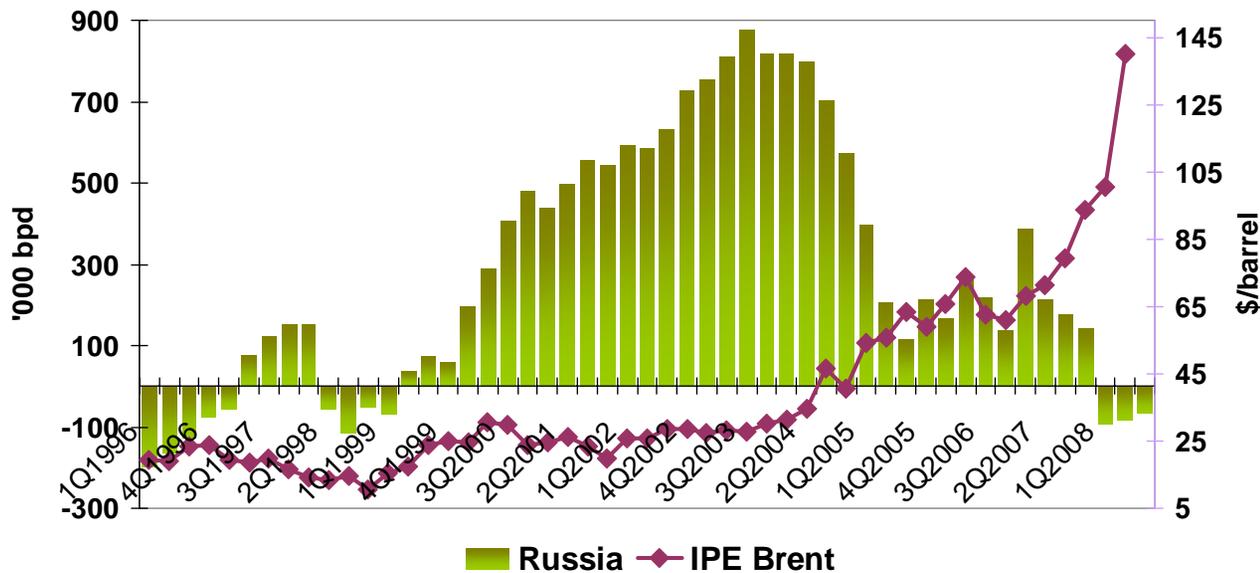
Annual change in global oil supply

Source: IEA



# Economics 101 revisited: High prices beget low supply

Russia crude production growth vs Brent futures  
Bloomberg, IEA

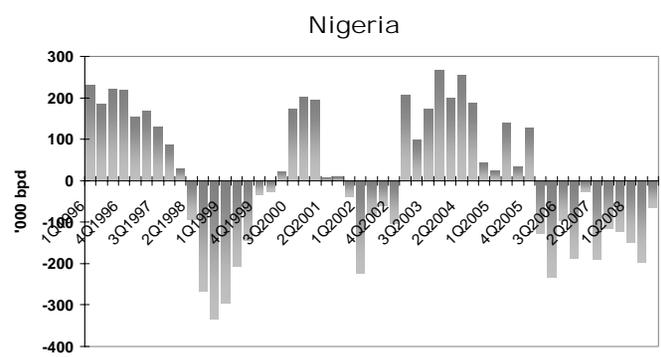
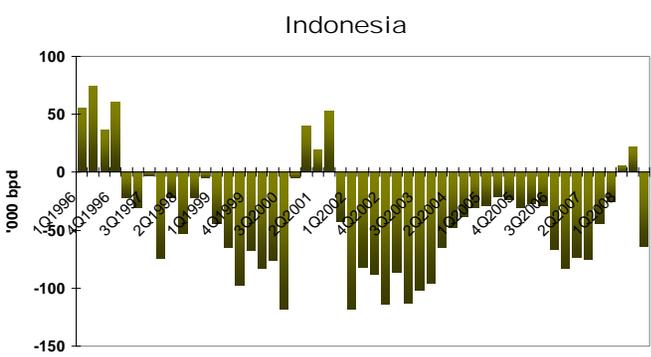
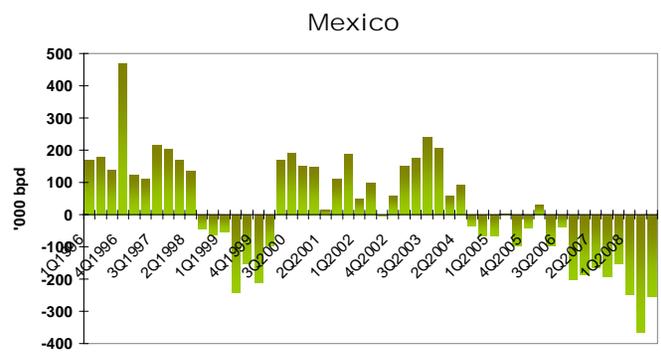
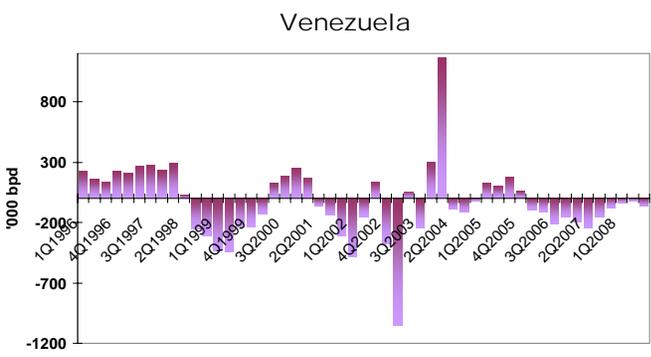


- Russian supply growth ground to a halt when prices took off
- Set the stage for resource nationalism worldwide
- Politics of oil empowerment
- Unburying the oil hatchet



# The politics of production decline

IEA



# Oil supply: from rent capture to market share

- Peak oil-nationalism?
- Falling prices and output undermine nationalistic stance
  - Russia: oil tax cuts?
  - Nigeria: Niger Delta fix?
  - Mexico: constitutional reform?
  - Venezuela: Russia to the rescue?
- OPEC's behind-the-curtains crisis
  - Institutional stress
  - Price management exposes divisions
  - Market sell-off to test group's discipline
  - OPEC downcycle
- Constraints on liberalization
  - Costs
  - Labor supply
  - Unrest / social stability



# Turning a corner on supply

- Non-OPEC: from nearly flat growth in 2008 to +500,000 bpd 2009
  - FSU (+230 kb/d) (Russia -150,000 bpd, Caspian +370,000 bpd)
  - Brazil (+280 kb/d)
  - China (+80 kb/d)
  - US +300,000 bpd
  - Canada +120,000 bpd
- OPEC NGLs +800,000 bpd (+300,000 bpd 2008)
- OPEC
- Saudi Arabia:
  - Demand destruction raising concerns on the economy, demand security
  - Fuel substitution threatens oil's role in sustaining global economy
  - Shaybah 250,000 bpd expansion
  - Nuwayyim 100,000 bpd
  - Khursaniyah 500,000 bpd + 300,000 bpd liquids
  - Khurais 1.2 million bpd June 2009?
  - Manifa 900,000 bpd heavy crude mid-2011
  - Zuluf / Safaniyah /Berri
  - 9.7 million bpd production July 2008
  - 12.5 million bpd capacity end-2009
  - 15 million bpd



# Midstream from crunch to bulge

- Tight refining capacity was key driver of high prices
- Tug-of-war between refiners and suppliers helped inhibit OPEC upstream investment
- Demand crunch + East-of-Suez expansion restore slack in system
- Peak refining capacity in the US and Europe?
- Surging refining capacity expansion:
  - Middle East
  - India
  - China
  - Petrobras
- OECD increasingly off-shoring refining/growth in global product trade
- Non-OECD demand growth: impact on demand seasonality
- Redistribution of demand growth opens opportunities for arbitrage and trade
- Market depth & flexibility
- Oil market triangulation



# Political risk

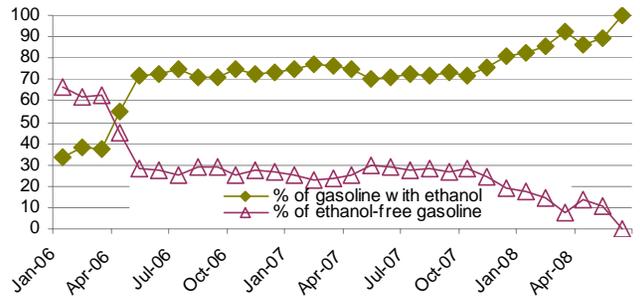


- **Social stability in producer countries a concern**
- **But risk of military confrontation in Iran declines in a low-price environment**

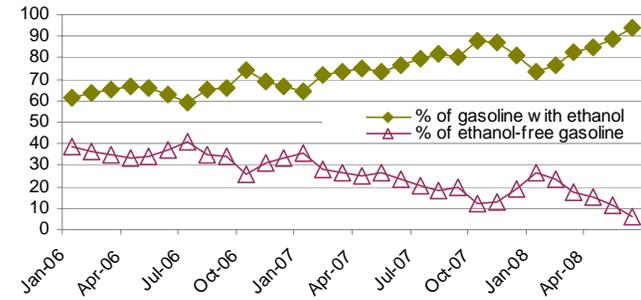


# US ethanol running out of space...

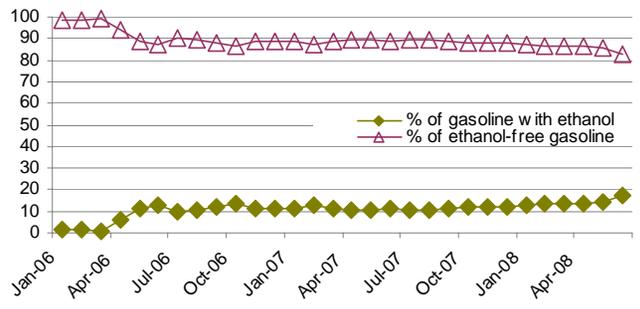
US East Coast ethanol penetration:  
domestic gasoline output



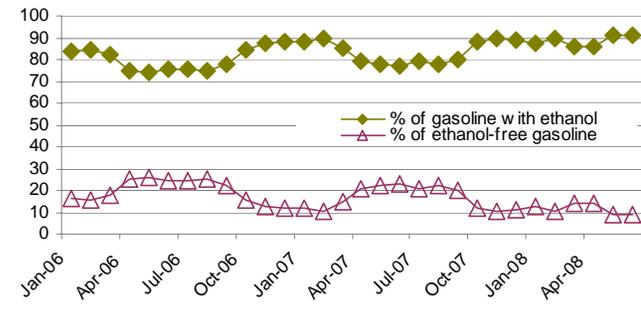
US Midwest ethanol penetration:  
domestic gasoline output



US Gulf Coast ethanol penetration:  
domestic gasoline output



US West Coast ethanol penetration:  
domestic gasoline output



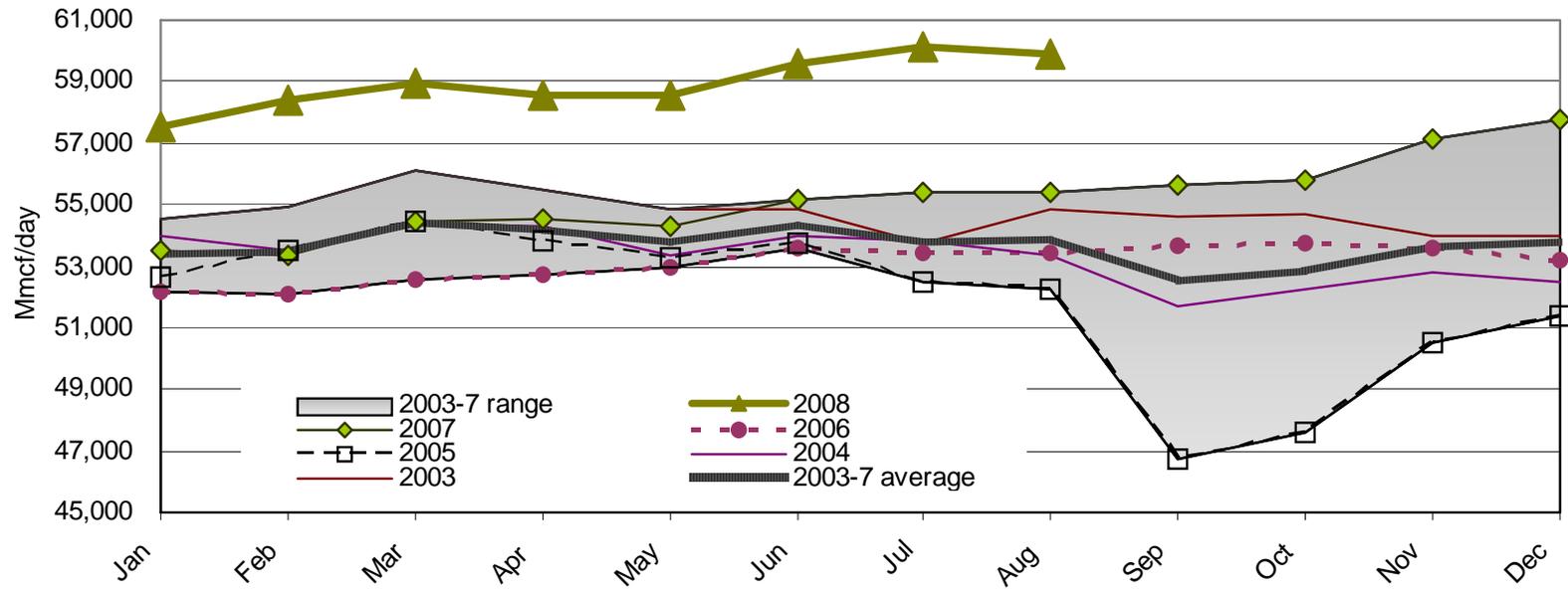
# .. But alternatives prospects may rise in a low-price market

- Import substitution pressure looks set to ease
  - Energy demand growth goes south
  - More supply
  - Lower prices
  - Ethanol backlash
  - US and global crisis in renewable policy
- Renewed interest in export maximization
  - Lower prices to rekindle quest for market share and volume growth
  - Supply growth recovery
  - Interest in export maximization



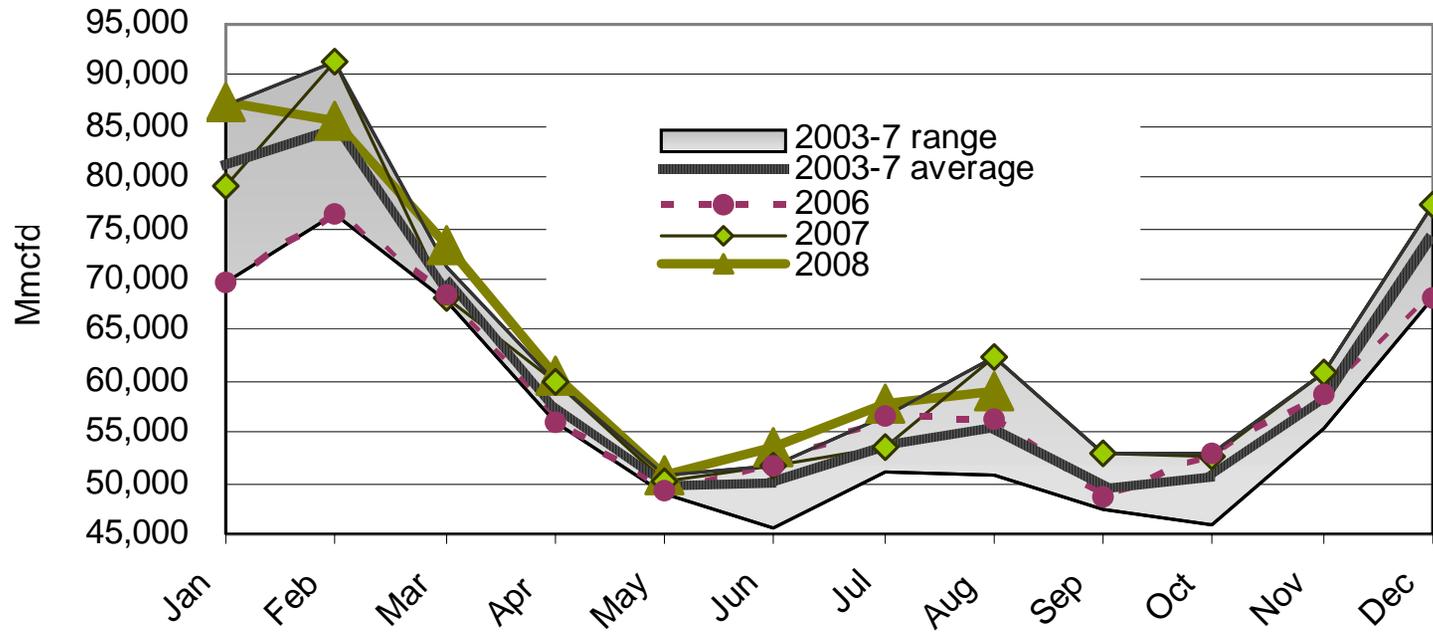
# The age of non-conventional gas

US natural gas marketed production  
Source: US EIA



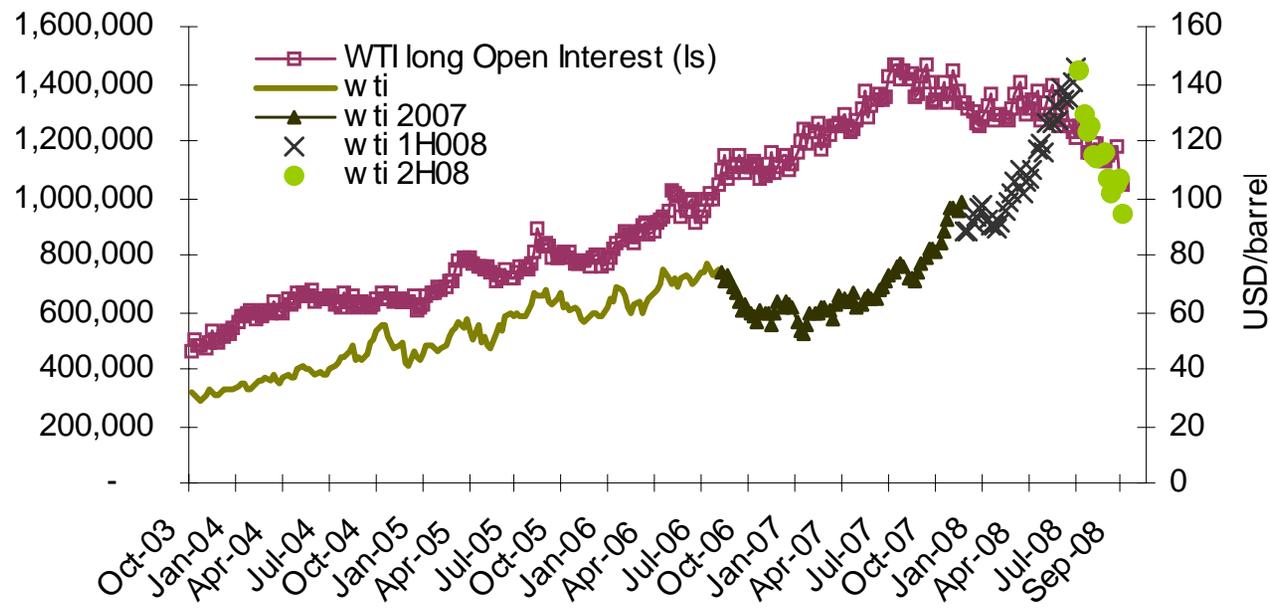
# US natural gas demand resilience

Total US natural gas demand  
Source: US EIA



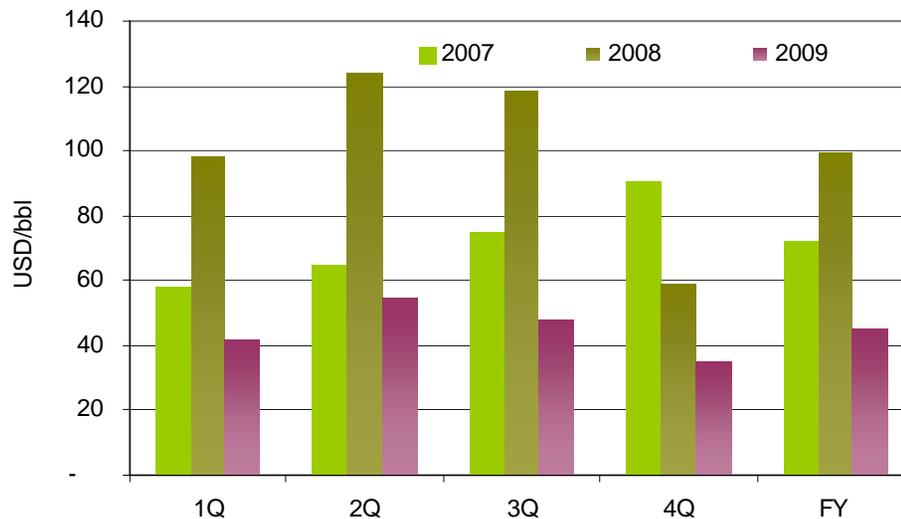
# De-leveraging: oil market impact

**NYMEX WTI Open Interest v. Price**



# Price Scenario

WTI Price Forecast					
\$/bbl	1Q	2Q	3Q	4Q	FY
2007	58.27	65.02	75.15	90.50	72.36
2008	97.82	123.80	118.22	59.08	99.75
<b>2009</b>	<b>42.00</b>	<b>55.00</b>	<b>48.00</b>	<b>35.00</b>	<b>45.00</b>



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