THE FUTURE OF ENERGY

Six Insights from Daniel Yergin

AT PERELLA WEINBERG PARTNERS, we believe insights drive markets. Periodically, we will offer fresh commentary on market-moving issues from PWP experts—each of whom brings deep experience, front-line knowledge and unique perspective. In this edition, we feature renowned energy expert and PWP Advisory Board Member Daniel Yergin. Daniel is author of the New York Times best seller, The Quest: Energy, Security, and the Remaking of the Modern World, and The Prize: The Epic Quest for Oil, Money and Power, for which he won the Pulitzer Prize. He is Vice Chairman of IHS and founder of IHS Cambridge Research Associates.
The U.S. shale oil boom and Iranian nuclear agreement combine to intensify today’s oil downturn.

Each oil downturn over the last 30 years has been different. The most dramatic difference now is the extraordinary growth in U.S. shale oil—an almost doubling between 2008 and April 2015. That surge has put the U.S. back at the forefront of world oil producers and, to some degree, turned the U.S. into an inadvertent swing producer. Another big difference is the intensity of the rivalry between Iran and Saudi Arabia—and the significance of lifting sanctions on Iranian oil. Estimates of the amount of oil Iran could bring to market over the next few months range from 300,000 barrels per day upwards to 1 million. That’s a big uncertainty hanging over the market.

Reports of shale oil’s demise have been exaggerated.

The current market has driven greater efficiency and innovation, and that makes shale more competitive. It turns out that shale oil is not, overall, “high cost.” It is “medium cost.” Shale oil will certainly be competitive in the future at prices well below $100. But if prices remain in the $30s or lower, we will see a lot of distress, all the more so because of the debt burden many companies carry.

Defeat of Keystone Pipeline energizes opposition to all new energy infrastructure products.

The organized opposition to energy infrastructure projects continues to grow more organized. It seems to take longer and longer, and is harder and harder, to get full approval for many projects. TransCanada spent seven years and billions of dollars seeking approvals on Keystone, only to get turned down. The U.S. certainly needs new pipeline infrastructure to help move the new oil and gas resources. Some have estimated that the carbon footprint of removing sanctions on Iranian oil is more than that attributed to Keystone.

The commodity “supercycle” in China is over.

The slowdown in China is one of the main reasons for the weakness in oil demand that helped precipitate the price collapse. Between 2003 and 2013, China was responsible for 45 percent of all the growth in world oil demand. China, of course, is a much bigger economy today. But the commodity supercycle that it drove is over. During that supercycle, not only were prices going up, but so were costs. Today, there is a tremendous emphasis on finding ways to drive down costs and be more efficient. There’s no choice.

Renewables will double by 2022.

The fall in oil prices does not have much impact on the alternatives like wind and solar because they operate in different markets. Wind and solar compete with natural gas and coal to supply electric power. The most significant development for wind and solar is the extension of federal tax credits. That, in IHS’ estimate, will more than double the growth in new renewables between now and 2022. Requirements by states for renewable electricity and the Obama Administration’s Clean Power Plan, if it goes forward, will further bolster renewables.

Two factors—geopolitics and supply/demand—will continue driving oil markets.

First, geopolitics is still driving the price of oil, but driving prices up, not down as it normally does due to supply disruptions. The biggest factor is the rivalry of Iran vs. Saudi Arabia and the Gulf Arabs intent on saturating the market. But a political disruption in Venezuela, Iraq or elsewhere, possibly brought on by the very stress of low prices, could reverse the process. Second, oil cycles will continue. Cycles were not abolished when oil was $147.25, nor when oil is $30. At oil’s current level, the industry cannot invest to meet demand three or four years down the road. So the severe downturn could simply be brought to an end by the workings of supply and demand, including a continuation in the fall in U.S. output. Or the financial challenges could become so difficult that major OPEC and non-OPEC exporters make a credible deal to limit supply.