

THE ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM – 2009

4–6 JUNE 2009, ST. PETERSBURG

THE PRICE OF OIL

Moderators:

Guy Chazan, journalist, *The Wall Street Journal*; **Rair Simonyan**, Chairman, Morgan Stanley
Russia

Panellists:

Igor Sechin, Deputy Prime Minister of the Russian Federation

Dr. Daniel Yergin, Chairman, Cambridge Energy Research Associates

Nobuo Tanaka, Executive Director, International Energy Agency

Edward Morse, Managing Director & Head of Research, Louis Capital Markets

Peter Caddy, Business Development Director, Argus Media

Discussion participants:

Alexei Miller, Chairman of the Management Committee, Gazprom

Vagit Alekperov, President & CEO, LUKOIL JSC

Vladimir Bogdanov, General Director, Surgutneftegas

Sergey Bogdanchikov, President and Chairman, Rosneft

Shafagat Takhautdinov, General Director, Transneft

Viktor Vekselberg, Executive Director, TNK-BP

James Mulva, CEO, ConocoPhillips

Paolo Scaroni, CEO, ENI

Fulvio Conti, CEO, ENEL

Hedge Lund, CEO, StatoilHydro

Tony Hayward, Group Chief Executive, BP

David J. O'Reilly, Chairman and CEO, Chevron Corporation

Jeroen van der Veer, Chief Executive, Royal Dutch Shell plc

Andrew Gould, CEO, Schlumberger

While acknowledging that the future oil price cannot be accurately forecast, all participants in the discussion noted the need for a more stable and predictable oil price environment. Igor Sechin, Russia's deputy prime minister, opened the discussion, highlighting the importance of the \$2trn oil market to the global economy, and stating his view that the oil market's mechanisms are far from perfect. He added that oil prices do not reflect the underlying supply/demand balance, and are susceptible to significant volatility through the influence of financial investors and geopolitical factors. He also noted significant regulatory risks, destabilising the oil markets and resulting in oil-price volatility. Finally, Sechin said he regards the current global monetary mechanisms as outdated, and not reflective of the current state of the world economy. Sechin regards the creation of a stable, long-term oil market architecture as a priority, and noted three areas for improvement here:

Improving benchmark crude pricing. This may be achieved by including a greater variety of crude blends in the list of traded commodities. Current pricing for these are based on discounts to the listed benchmarks (WTI and Brent), and are hardly transparent. Sechin's comments were echoed by Peter Caddy, business development manager of Argus Media, who noted that the movement of oil-consuming centres to the East, and the build-up of Russia's crude production and transportation capacity in East Siberia and the Far East, should allow for independent benchmark pricing of Russia's crude in the future.

Improving the pricing mechanisms for oil. The oil price must be supported by transactions in real commodities, as opposed to being used as a financial investment. Global financial investments caused the oil price to spike over 2002-2008, with financial contracts accounting for 10bn bbl at the peak, vs annual production of 88mn bbl, according to Sechin. Rules and regulations governing financial investments in the commodity of oil should be reassessed to bring the volume of financial investments into line with physical volumes. The unification of long-term contracts with defined delivery terms should reduce the influence of financial investors. The list of parties to such contracts should be predefined, excluding the influence of economically unjustified agents.

Reducing systemic risks. Sechin believes oil prices should be maximally delinked from volatility in the currency markets. Within the current set-up, the oil market could prove a hostage to US government decisions. Oil trading should, therefore, move to multi-currency trading and settlements, according to Sechin.

The end result of this approach should, it was noted, be more transparent, stable and predictable oil pricing. Russia is the largest oil producer in the world, and should participate in the build-up of a new crude-trading infrastructure. In the meantime, the country is responding to changing market conditions by stimulating greater complexity of refining, maintaining the level of investment activity in the oil industry (including the construction of new pipeline infrastructure) and keeping crude production flat. According to Sechin, these measures will promote stability in the supply of oil and oil products globally.

In the discussion that followed, little consensus emerged on the future price of oil, with the oil-company CEOs present notably more bullish in their outlook than representatives of the analytical community. The organisers of the conference took an impromptu survey of the audience's view on the sustainable level of the oil price. The results showed separately the view of the oil companies' CEOs and the rest of the audience. 45% of the CEOs predicted an oil price range of \$80-90/bbl. The mean result for the rest of the audience was a more modest range of

\$70-80/bbl, reflecting the views of 32% of the attendees. All parties, however, agreed that three factors will shape the oil price going forward, specifically:

Demand for oil products, shaped by government policies, efficiencies, climate-change policies and an emphasis on innovation. Most participants agreed that OECD demand for crude is flat-to-declining, with the bulk of future growth coming from non-OECD countries. In particular, future Chinese oil consumption is uncertain, but could be the biggest growth driver. Nobuo Tanaka, executive director of the International Energy Agency (IEA), said that, while the short-term trend is uncertain, the longer-term trend is upwards, as the world will continue to rely on fossil fuels for the foreseeable future. David J. O'Reilly, chairman and CEO of Chevron Corporation, added that alternatives will not be able to deliver the energy required at the scale to meet demand.

The supply of crude. Oil supply, in turn, will be shaped by the long-term view on the oil price, development costs and government regulations. While the IEA notes that investments in the oil industry will fall 21% in 2009, leading to a reduction of supply capacity, Edward Morse, managing director and head of research at Louis Capital Markets, argued that this simply reflects much lower development costs (with marginal costs for the development of Canadian oil sands having declined from \$90/bbl to below \$60/bbl over recent months). Daniel Yergin, chairman of Cambridge of Energy Research Associates, drew attention to the significant remaining potential of brownfield developments globally, and urged regulators to improve fiscal regimes to assist oil companies in improving recovery from existing assets. Representatives of the oil companies participating in the discussion noted that while investments have declined somewhat in 2009, there has been no significant reduction, and noted the need for a sustainable level of capex to ensure stable levels of supply in the future. TNK-BP Executive Director Viktor Vekselberg noted the importance of Russia's costs structure and fiscal regime as a determinant of future oil prices, while LUKOIL's president and CEO, Vagit Alekperov, highlighted the need for an increasing rate of exploration activity globally, in order to avoid production declines in the future.

Oil-market infrastructure. Discussion participants noted the importance of open markets for efficiency and innovation. At the same time – echoing Sechin's remarks – they acknowledged that the current market architecture could be improved. According to Morse, Russia, as a large stakeholder in the oil market, could become a more active participant in shaping the oil trading infrastructure of the future.