

## YOUR SPE

# Global Economic Crisis— Challenges for Industry and for SPE

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President's Forum: [www.spe.org](http://www.spe.org)



In my columns up to now, I have completely ignored the fact that the world is in an economic crisis at the moment. This is not because I travel around so much that I don't realize there is something going on. The simplest reason is that my column has to be completed more than 2 months before you read it because of publishing deadlines. The second reason is that SPE is a professional society that offers a forum for like-minded individuals in which an exchange of technical ideas and information can take place. In different words, we are not a lobbying organization and we do not do politics.

However, we are, as a society, part of the greater world and any crises, such as the current one, will affect SPE's operations. During the 50+ years of our existence, SPE has survived crises of all kinds, so I do not worry too much. SPE is financially very robust, with a good reserve fund built up during the last decade of growth and good support from members and organizations. However, everything SPE does is around oil and gas and that means that anything that affects oil prices will affect SPE.

So, what's going on? The oil market is inherently volatile; it has made a fool out of forecasters many times over the last decades, and it will make a fool out of me if I would even try to predict what will happen in 2009. On the one hand, we are made to believe that the current economic recession will end the growth in oil/energy use, which means that even if the supply growth slows, the extra production will not be needed and oil prices go down. Against that short-term view, there are a number of thinkers from our own industry, who I will cite here, who argue that our industry requires a long-term view. Analysis from sources such as Simmons & Company Intl., Douglas-Westwood, and the Paris-based energy think tank International Energy Agency (IEA) can be found on their web sites.

What they are saying is that, at the moment, many of the world's economies are still robust. The economies of India, China, and the Middle East are still growing, and China has a USD 1.9 trillion cash war chest. Of course, the financial crisis could spread into a serious economic downturn (and since this column is printed months after I write it, you will know), but oil demand should still grow in the longer term. In the short-term, new oil supply additions will get delayed because of the credit crisis. Mega energy projects may get delayed or cancelled, so supply will fall. But a recession will mean that demand for oil uses will decline, too. According to the *Financial Times*, the floor under the oil price is set by the level at which significant volumes of production become uneconomic, which the 21 December 2008 *Financial Times* says is around USD 30 to 40. However, if the industry slows down and production costs decline, that level will go even lower.

But look at some numbers from Simmons<sup>1</sup>: China now uses 8 million BOPD (its use was 3.5 million BOPD in 1997). India now uses 3.2 million B/D.

Current USA demand totals 24 bbl/person/year. China uses 2.3 bbl/person/year and India uses 1.1 bbl/person/year. Compare this with Mexico, which uses 7.5 bbl/person/year. If India and China used the oil equivalent of Mexico, supply would need to grow by 50 million B/D!

The IEA predicts<sup>2</sup> global oil use to exceed 100 million B/D by 2030. Even if oil demand were to remain flat to 2030, 45 million B/D of gross capacity—roughly

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- 
- Environment:** Sognefjord sandstone with hard calcite stringers, Troll Field, Norwegian North Sea.
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four times the capacity of Saudi Arabia—would be needed just to offset decline from existing oil fields.

To supply this demand, global investments of the order of USD 20 trillion need to be made and major technology breakthroughs are required to achieve this. So, in the long term, our industry will soar. However, although the long-term future might look rosy, the short term might be bad, particularly for small entrepreneurial companies that are struggling to get a loan to drill the next well. What do the gurus say about this?

An interesting analysis came from Douglas-Westwood,<sup>3</sup> who compared majors, mid-tier IOCs, independents, and NOCs in their reaction to lower oil prices and restricted availability of credit. The conclusion was that the credit crisis and consequently lower oil prices will have little impact on the majors, due to conservative hurdle rates and large-scale developments. Investments may have to be funded from cash flow, which means cutting share buy-back programs. The main impact is expected to be with the smaller independents and perhaps the mid-tier IOCs, which may have to cut their exploration programs and review/delay investment plans due to less conservative hurdles and greater dependence on external finances. The NOCs will be affected by falling oil prices, and push for production cuts. Reviews of their investment plans might be in order.

Responses from industry leaders have been mixed. Some, like Exxon Mobil, have stated that their investment plans are unchanged, while others are reviewing spending. For cash-rich companies, these might be the days for cheap acquisitions.

We live in interesting times, where lots of things can happen. I do hope that one thing will not happen, and that is that companies forget about the long term. As I stated earlier, it is vital to keep investing in new technology. Focus on short-term demand issues and loss of focus on supply-side constraints, which can only be solved by new technology, could lead to another sharp "supply crunch" when the global economy recovers. Because, like the financial crisis, the energy crisis is real—it has been building for years. All predictions show that supply is waning. An oil-price collapse will trigger a serious risk that demand will pull ahead of supply, resulting in another uncontrollable jump in oil price.

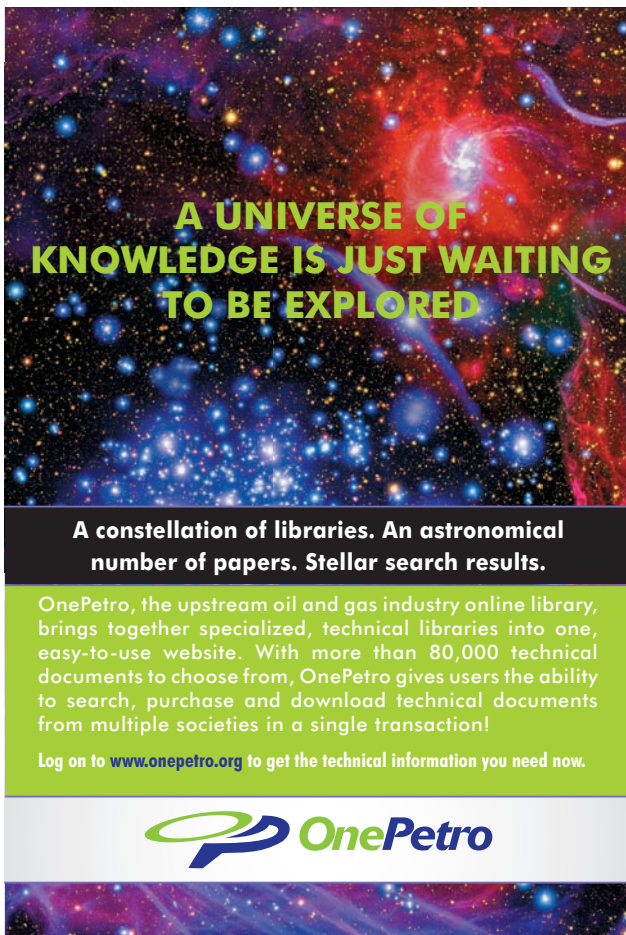
How will this affect our society? As mentioned, SPE is financially very robust. However, with the world in economic slowdown, "business as usual" and "steady progress" will not be good enough in 2009. We will have to take a good look at what our members need and continue to deliver high-quality, cost-effective services and do that consistently. Every one of us must feel that SPE is there for all of us, helping to disseminate knowledge, in bad times as well as good. If we are going to see major budget cuts throughout the industry, there is a risk that fewer people will attend conferences, workshops, etc., which provide most of SPE's revenues. This could put some of our programs at risk, especially those that are not of benefit to the majority of members. Although we have a healthy reserve fund, it is prudent to protect its long-term use and be fiscally responsible in our annual budgets. The SPE Board of Directors is very aware of this and will try to minimize the impact on services important to our members.

Please tell your leaders that in times when costs need to be carefully managed, the professional societies like SPE are the most cost-effective way for you to learn, to innovate, and to find ideas to make your operations more productive. With that in mind, I can only conclude that in good times and bad, SPE will always be there to help you!

#### References

1. Simmons, Matthew R.: "Understanding Energy Risk and Crisis," presentation at Leaders Dialogue, Hamburg, Germany, 31 October 2008. Available from /www.simmonsco-intl.com.
2. *World Energy Outlook 2008*, International Energy Agency, Paris (2008).
3. "Turmoil in the Credit Markets: The Impact on the Oil & Gas Sector," Douglas Westwood (3 November 2008). Available from www.dw-1.com.

**JPT**




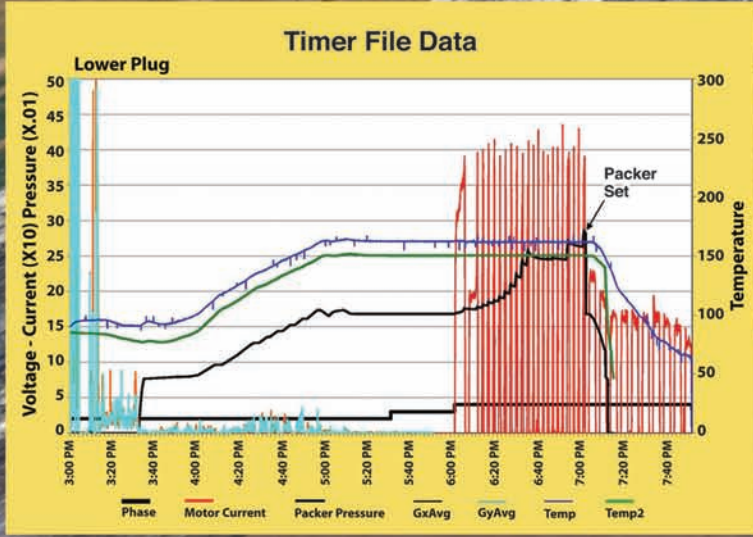
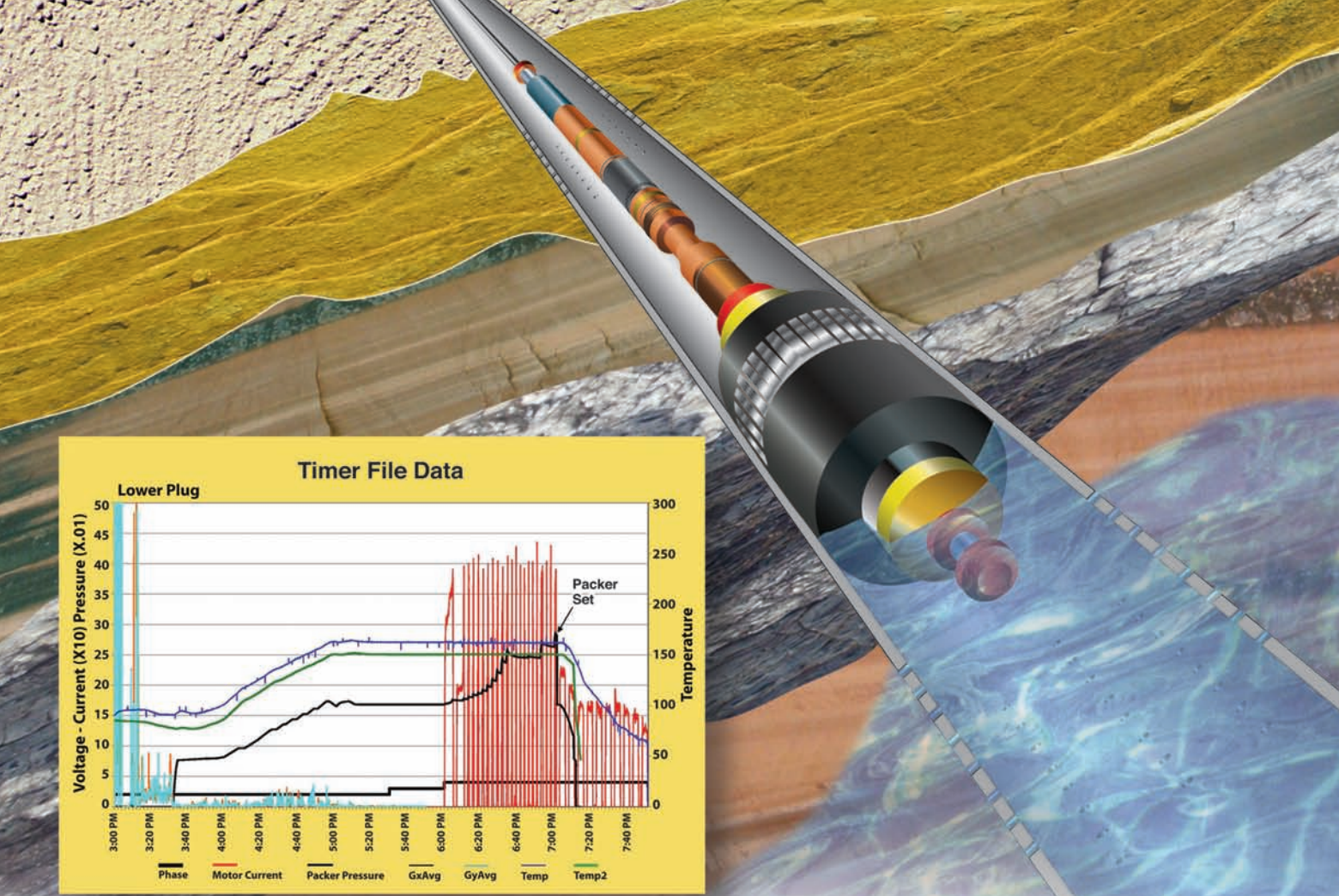
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