US boom transforming global oil trade

May 14 2013, by Jonathan Fahey

In this Tuesday, July 26, 2011 file photo, Ben Shaw hangs from an oil derrick outside of Williston, N.D. The surge in oil production in the U.S. and Canada and shrinking oil consumption in the developed world is transforming the global oil market. (AP Photo/Gregory Bull, File)

The surge in oil production in the U.S. and Canada and shrinking oil consumption in the developed world is transforming the global oil market. The threat of chronic oil shortages is all but gone, U.S. dependence on Middle Eastern oil will continue to dwindle, and oil will increasingly flow to the developing economies of Asia, according to a

five-year outlook published Tuesday by the International Energy Agency.

The changes will have "significant consequences for the global economy and oil security," the IEA says.

The report paints a picture of a world with plenty of oil to meet modestly growing demand. Where the oil is coming from, and where it is going, is changing dramatically, according to the IEA, an energy security and research organization based in Paris that serves 28 oil-importing countries, including the U.S.

The report does not address oil prices directly, but analysts do not expect the changing oil market dynamics to lead to sharply lower oil or gasoline prices. The abundance of oil does, however, greatly reduce the risk of sustained price surges that curtail economic growth.

The chief impetus for the changing world oil picture is the increase in production in the U.S. The U.S. created the world oil market more than a century ago and is the world's biggest consumer, but domestic production was thought to be in permanent decline. Then drillers, inspired by high prices and armed with improving technology, learned how to produce oil from previously inaccessible rock under several U.S. states.

U.S. production reached 7.4 million barrels per day early this month, 48 percent higher than the average production in 2008 and the highest it's been since February of 1992. The IEA expects U.S. production to reach 9.1 million barrels per day by 2018. The U.S. last produced that much oil in 1972.

Production is also projected to rise in Canada and elsewhere in the Americas, such as Brazil and Columbia. At the same time, oil demand in

the U.S. and other developed nations is expected to fall slightly, a result of improved vehicle efficiency and weak economic growth. That means the U.S. will be able to satisfy most of its own needs with domestic production and oil from neighbors—and that could have geopolitical implications.

"It will affect relationships between countries. Most leaders believe they have to be nice to whoever they buy their oil from," says Michael Levi, an energy expert at the Council on Foreign Relations and author of a recent book on the U.S. energy boom called The Power Surge.

U.S. petroleum imports have fallen by 22 percent since hitting a record in the middle of the last decade.

With lower demand in the West and higher production in the Americas, much less oil will flow from the Middle East to Europe and the United States. Instead, Middle Eastern oil will head to Asia and likely strengthen economic and political ties between the two regions.

Levi warns against overestimating the political and economic benefits of lower U.S. imports, however. Because the oil market is global, a supply disruption in the Middle East would send prices higher everywhere—including for U.S. consumers—even if the U.S. imports no oil from the Middle East. For that reason, the U.S. will still need to help maintain stability in the region.

Supplies in the Middle East will also change. Iraq's production capacity is expected to grow quickly, by 1.6 million barrels per day to 4.8 million barrels per day by 2018. Meanwhile, Iran's capacity is expected to decline by 1 million barrels per day, to 2.4 million barrels per day, as a result of Western sanctions imposed on the country's oil and financial markets. Saudi Arabia will continue to dominate production in the region.

Other members of the Organization for Petroleum Exporting Countries, such as Venezuela and African nations, will struggle to keep up, because of political instability and difficulty attracting investment in new oil fields.

OPEC may soon face some difficult decisions if new supplies from non-OPEC countries push prices lower. The group restricts production by its members in order to keep global oil prices high. In recent years, prices have been so high that member countries have been able to produce all they want. If prices fall, however, members could be asked to cut production at a time when those countries desperately need oil revenue to fund domestic programs.

"Pressure on OPEC is going to crank up," says Judith Dwarkin, Chief Economist at ITG Investment Research.

It is unclear whether, or how far, prices will fall. The new oil in the Americas is expensive to produce because it is found in difficult locations—deep offshore, trapped in oil sands, or in tightly-packed rock. Lower prices would force drillers to quickly pull back, or risk losing money. That would reduce supplies, and send prices back up. Analysts say that if prices fall below $70 per barrel for a sustained period, investment in the most expensive new projects will slow.

Average oil prices have been remarkably flat over the last three years. The price of oil averaged $95 per barrel in 2011, $94 in 2012 and $94 so far this year. That has kept average U.S. gasoline prices relatively stable too—averaging between $3.51 and $3.63 per gallon over the last three years. Tuesday's report had little effect on daily oil markets—oil closed down less than one percent to just over $94 per barrel.

Dwarkin expects oil prices to average near $90 a barrel for at least the next two years.

Oil demand is shifting as much as oil supply. Developing countries will soon, as a group, consume more oil than developed countries for the first time, according to the IEA.

The Middle East and Asia will need more oil as their economies grow. At the same time, the historically big oil consumers—the U.S., Europe and Japan—will use less. Overall, global demand is expected to rise 1.2 percent per year over the next five years.

While the IEA report doesn't address the oil market after 2018, it does suggest that the technology that helped lead to a boom in oil production in the U.S. will eventually help other countries produce more oil.

"It is impossible to ignore the possibility that current non-conventional technologies, as they spread and get both perfected and mainstreamed, could lead to a wholesale reassessment of global reserves," the report says.