Western Green Energy Mania Will Not Doom Oil and Gas Industry

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It would seem that the Middle East oil producers cannot get enough of bad news these days. The coronavirus pandemic and the collapse in global energy demand in the first quarter of 2020 led to oil prices plunging into the mid-teens as Saudi Arabia launched the oil price war against Russia in early March. Despite the subsequent historic OPEC+ deal in April to slash output by an unprecedented 9.7 million barrels per day (Mbd), oil prices have been stuck around $40/barrel since June. Prospects for an economic recovery for the Middle East – which already looked precarious after the steep fall in oil prices since mid-2014 as the US "shale revolution" took hold in global oil markets -- now look significantly worse than that of other emerging market regions.[1]

BP and Shell: Cutting Oil and Gas Output

In the midst of this calamity, BP made its bombshell announcement in early August of its intentions to slash its oil and gas output by 40% by 2030 from 2019 levels, by actively managing its investment portfolio in favour of low-carbon renewable energy.[2] The leading international oil company -- known for its influential annual global energy statistics reports – had come out with its latest 2020 energy outlook that suggests that oil demand may already have peaked in 2019. As if on cue, the other European oil major, Royal Dutch Shell, reported last week a similar 40% planned cut to its oil and gas exploration and development budget to "prepare for the energy transition".[3]

BP's outlook presented three scenarios – "business as usual" (BAU), "rapid (transition)" towards a low-carbon renewable energy future and "net zero" carbon emissions by 2050, of which the last two postulate 2019 as marking the global oil demand peak, steeply falling from 100 Mbd to 55 Mbd and 30 Mbd by 2050 respectively. In contrast, after recovering from the impact of Covid-19, the consumption of oil in BP's "BAU" scenario plateaus at around 100 Mbd for the next two decades, before declining to around 95 Mbd by 2050. Evidently both BP and Shell are convinced that the likely outlook for global oil demand growth is better approximated by either the "rapid transition" or "net zero" scenarios.

Despite repeated claims about the cost competitiveness of solar and wind energy, BP's scenarios of a "rapid transition" or a "net zero" world of carbon emissions by 2050 are ultimately founded upon government subsidies for solar and wind energy and electric vehicles, carbon taxes and policy mandates such as renewable portfolio standards.[4] Whether the developed economies will go all out for a Green Recovery – as called for by leading figures such as European Commission President Ursula von der Leyen,[5] chairman of the World Economic Forum Klaus Schwab[6] and Executive Director of the International Energy Agency Fatih Birol[7] – remains to be seen in the cold light of economic recession, record budget deficits and the need to kick-start their economies from their current Covid-19-induced comatose state. One has only to appreciate Poland's reaction to the EU's climate goals to be somewhat sceptical.[8]

Middle East: Under Existential Threat?

The Middle East accounts for 48% and 38% of proven global reserves of oil and gas respectively.[9] The announcements by BP and Shell to cut their oil and gas investments by 40% by 2030 would seem to signify an existential threat to the future viability of the region's oil and gas producers. Yet it would take a distinctly European view of the global energy future to pay credence to such an outlook.

A senior executive of U.S. oil producer ConocoPhillips said last week that he sees global demand returning to 100 Mbd and growing from there, with oil an "important part of the energy mix in any scenario" going forward.[10] The CEO of Chevron, Mike Wirth told an audience that the global push for clean energy "doesn't mean the end of oil and natural gas...it will be a part of the mix, just as biomass and coal are still enormous parts of the mix today".[11] These views are consistent with an IMF econometric analysis of the determinants of oil demand which predicts that global oil demand will peak around 2041 at about 115 Mbd.[12]

On the high road of the climate change crusade, sign-posted by corporate brochures extolling social responsibility and environmental sustainability, BP and Shell may be the first among the big oil majors. But that is not what makes the oil world tick. When Ali Naimi, the Saudi Arabian oil minister from 1995 to 2016, was asked in 2018 whether he saw a threat to oil demand from climate change policies and the increasing use of electric vehicles, he replied that "I would like to put everyone at ease, there are no such worries". Cynics will say that he spoke "his book". Yet history might be his best witness.[13]

Developing Asia: The Need for Oil (and Gas and Coal)

Developing Asian countries accounted for just over 70% of global oil demand growth in the five years to 2019.[14] That is, out of 7.3 Mbd growth in global oil demand over the period, developing Asia consumed 5.3 Mbd. In any credible scenario where governments retain legitimacy by delivering higher standards of living for their people, the Asian developing countries' appetite for oil (along with gas and coal) will mount for at least a few more decades to come.

It is implausible to believe that the developing countries in Asia, Africa and Latin America will undertake costly subsidies and infrastructure investments on intermittent and low-density "renewable" technologies – in the wake of the devastating Covid-19-induced lockdowns -- rather than invest in established energy system that has been developed over the past century.[15] China, for instance, approved nearly 10GW of new coal-fired power generation capacity in the first quarter of this year, roughly equal to the capacity approved for all of 2019.[16] In mid-June, India opened up coal mining to the private sector half a century after bringing it under state control, in a bid to boost the coronavirus-hit economy.[17] The International Energy Agency found that "global approvals of new [coal] plants in the first quarter of 2020 (mainly in China) were at twice the rate seen in 2019", with a long pipeline of projects under construction.[18] Wood Mackenzie, a consulting company, estimates that there will be a net increase in global coal-fired power capacity this year, with 22 gigawatts of closures in Europe and the US more than offset by 49 gigawatts of plants opening in Asia.[19]

If there is bad news for the Middle East oil producers, it has little to do with peak oil demand. It would be that they failed to exploit their treasure of energy reserves to help themselves while their oil sales rescue the rest of humanity in the developing countries from the ravages of energy poverty.

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Footnotes

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