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How the US found an extraordinary solution to oil supply risk

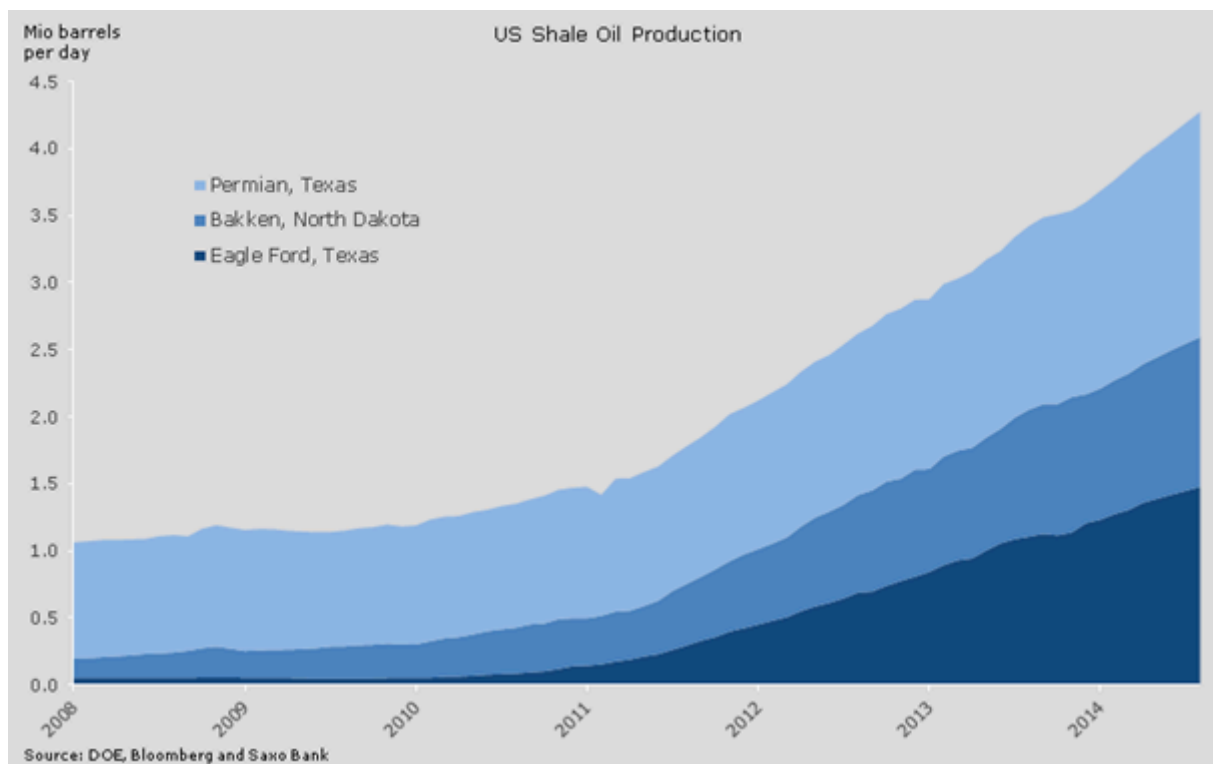
By Ole Sloth Hansen, Head of Commodity Strategy

A new report from the US Energy Information Administration highlights the extraordinary rise in US liquid fuel production over the past few years and how it has helped off-set unplanned supply disruptions which are running at the highest level since the Iraq-Kuwait war some 24 years ago.

The report has done a very good job in clearly describing what we already knew, namely that oil markets since 2011 have become less price sensitive to actual and potential supply disruptions. Especially to those numerous geopolitical events that has taken place since the Arab spring and the overthrow of Libya's Muammar Gaddafi in 2011.

From 2011 up until this July, US production of liquid fuels – crude oil, gas liquids and biofuels – grew by more than four million barrels per day. Of this, three million barrels came from the growth in crude oil production, primarily from new unconventional production techniques such as shale oil extraction.

The chart below shows the phenomenal rise in shale oil production from the three biggest areas of production in Texas and North Dakota. The rise in shale oil production is currently expected to continue up until 2020 after which time it will stabilise before falling the next decade. Continued high prices or a reduction in extraction cost from continued innovations in production techniques will be required for this to happen.



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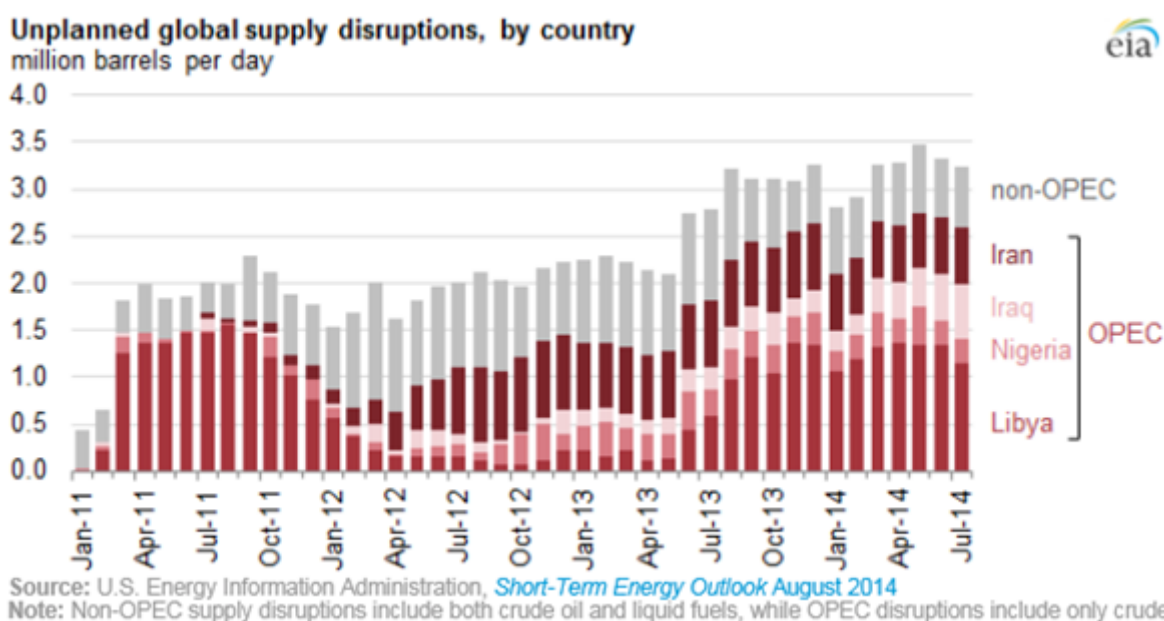
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Turning to supply disruptions, the EIA estimates that global unplanned supply disruptions averaged 3.2 million b/d during the first seven months of 2014. Of these, a vast majority came from OPEC producing nations, especially Libya, Iran and Iraq. Libya saw its production collapse last August when rebels began a year-long harbour blockade which has only now begun to be lifted. Iran's production was cut back in 2012 following the introduction of Western sanctions in response to the uncertainty over the country's nuclear intentions.



Talks between Iran and a group of Western countries together with China and Russia have been ongoing since last year and today, the Russian Foreign Ministry in a statement expressed some optimism that the talks could lead to an eventual lifting.

The result of increased US production and subsequent rise in exports of products have triggered reduced demand for foreign imports, especially from producers in Africa. This has helped to create a supply glut in the Atlantic basin which is the main reason why crude oil has come under some selling pressure in recent weeks and why Brent crude oil has seen the price of spot crude fall below deferred for the first time since 2010.

Brent crude oil, the current benchmark for the price setting of a majority of global oil transaction has now been averaging \$110/b since 2011. While we have seen price spikes and major sell-offs during this time, volatility has continued to come down as the increase in non-OPEC production has helped reduce the risk in the market.

The chart below shows how the oil price has behaved during numerous geopolitical events since 2011 and what is telling is that peaks have become more and more shallow with big producers such as Saudi Arabia having been able to meet any potential short falls and thereby help maintain a steady price. Following each

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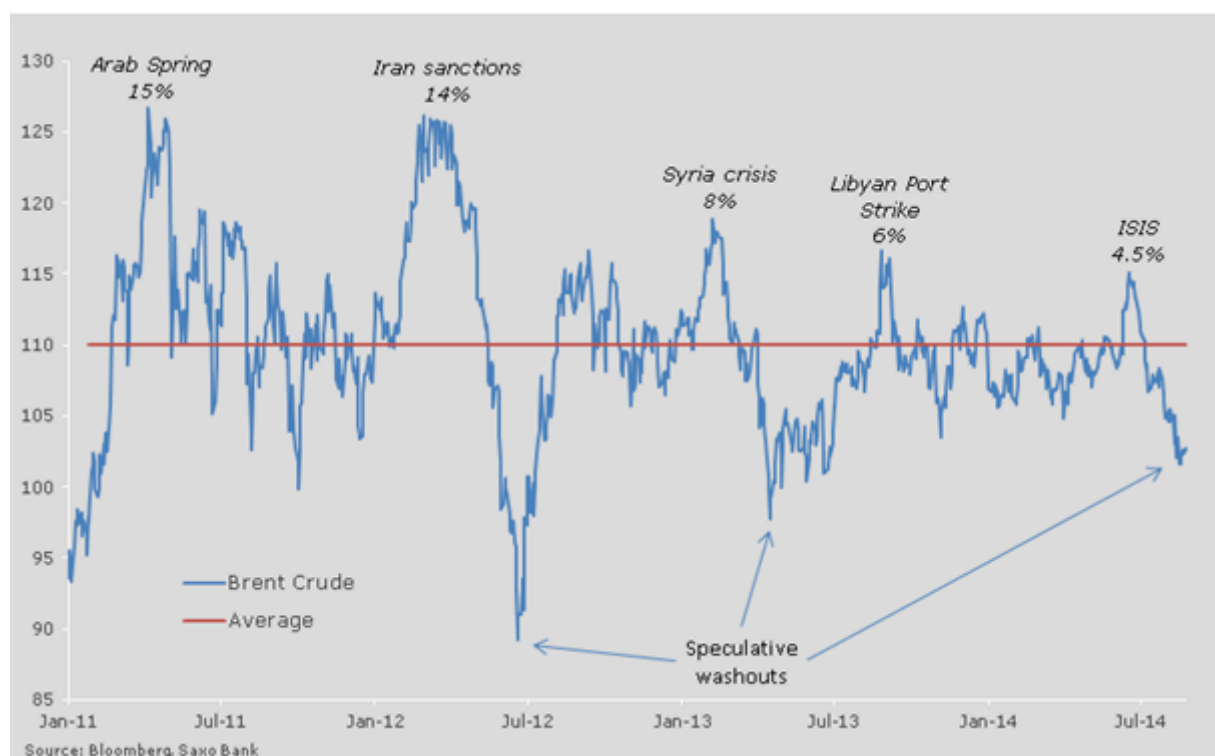
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peak, speculative traders such as hedge funds were forced to exit loss-making positions and this, at least up until the current sell-off, has been the main driver behind the price slumps.



For more information

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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years' experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.

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