Oil sub-sector

Sliding oil prices: The power of innovation

A.B. Kasozi, Academic

The current slide in crude oil prices is not only due to under-performance of consuming economies, but also to new technologies, which have improved methods of oil mining and more efficient ways of energy use.

The new technologies of mining oil from shale, improved oil conservation methods and strategic planning have reduced dependence on imported oil by formerly large importers like the US. As a result, there is more crude oil on the market than can be sold. It is believed that for every 100,000-barrel decline or rise in supply, prices rise or fall by about $1 a barrel.

The strategy of keeping prices low by pumping more oil on the market to weed out small shale oil competitors by traditional exporters can only be temporary.

The long-term strategy for developing oil-exporting countries is to acquire new mining technologies, add value to their oil before export, educate their populations to better manage their resources and diversify their economies to reduce dependence on vulnerable export of primary commodities for national income.

Oil prices are vulnerable

Crude oil prices, like those of other unprocessed commodities, are vulnerable and fluctuate like the weather. Oil-rich developing nations should not trust export of raw commodities as redeemers of their poverty. The last 50 years should have taught us three lessons; the vulnerability of oil prices, the deception of massive influx of oil money in countries without institutions to manage the bonanza and the difficulty of managing the oil sector better than we manage our societies.

Between 1970 and 2014, oil prices have fallen and risen like states and empires. Oil states have become wealthy and conflict-ridden, while others spent so much that when the windfall exited they became bankrupt.

In 1970, oil prices hovered around $2 to $3 a barrel. However, after the 1973 Middle East War, the price of oil rose from $3.5 in 1972 to over $12 a barrel. From 1975 to 1978, prices stabilised, but in 1979, following the deposition of the Shah of Iran, the installation of an Islamic Republic and the subsequent Iran-Iraq war, prices skyrocketed. The unpredictable political situations of "petro states" of the Middle East and Africa also affect oil prices.

To gain energy security, western nations not only conservatively used what reserves they had and searched ways to get away from fossil fuel bondage, but also began to look and drill for oil within their borders. The exploitation of the North Sea and Alaska fields contributed to the fall of oil prices in the early 1980s. By 1980, crude oil prices had dropped to about $10 a barrel.

However, politicians intervened to hike prices. The price of oil hiked to $40 a barrel when Iraq invaded Kuwait in 1991. Although prices stabilised after the war, the Asian financial crisis of 1998-9 sent oil prices tumbling back to $10.00 a barrel. When the Asian giants recovered, oil prices rebounded and within nine years, a barrel of Brent crude was fetching $147. However, this peak did not last.

The 2008-2009 subprime financial crises that began in the USA and adversely affected most of the industrialised world, sent oil prices rolling downward to $40 a barrel. To protect prices, OPEC, in 2008 agreed to cut production by 4.2 million barrels a day from January 1, 2009 to get better prices.

By June last year, oil prices stood at $107.48 of Brent and $105 for West Texas Intermediate (WTI) a barrel. However, the influx of shale and tar sands derived oil on the market and the slowing down of consumption by global economies sent prices rolling downhill.

By January 7, 2015, Brent crude oil was selling at $51.10 and WTI at $ 47.93 a barrel. The current price drop of about 50% in a period of five months or 10% each month is a worrying phenomenon for expecting producers like Uganda and Kenya.

An oil field in Sudan. Crude oil prices worldwide continue to fall despite oil being on a high demand

> All Uganda needs to do is to create mechanisms to endure the storms. The option is value addition before export to maximise profits.

The power of technology

The price war between traditional drillers and users of "unconventional" new methods is not only a competition between nations and regions, but also a competition between new and old mining technologies.

The US, which has led the world in a number of innovative technologies, is using new oil mining technologies to extract oil from shale soil and rock formations. These technologies are propelling the USA as the number one crude oil producer. Using "fracking", technology, a number of US companies have been able to extract oil from shale basins where they could not before.

Began in 1947, commercial hydraulic fracturing was not commercially operational until 1994. Fracking or hydraulic fracturing is the method of extracting oil (and gas) from shale soils or rocks. A mixture of water, sand and various chemicals is pressured into shale formations to extract the required minerals. The discovery of large shale formations in the US (North Dakota, East Texas, Oklahoma and other states) and across the world has made it possible for investors to sink their capital in "fracking" to get oil from shale formations. But the US, ever innovative in the past, not only possesses the institutions and structures to manage its own oil but has the ability to face declining oil reserves.

What are underdeveloped countries to do?

Underdeveloped oil producing nations are fighting back to hold on their markets by keeping prices low so as to make fracking operations unprofitable. The strategy is to let the law of supply and demand eliminate those who cannot sell below the "break even" point, which is estimated to be $80 for small companies and possibly $50 a barrel for big ones. However, Saudi Arabia can produce oil for $5-$10 a barrel. Further, shale wells decline rapidly, by 60-70% a year and many of the shale wells could dry up in about five years.

Underdeveloped oil producing countries face challenges of constantly changing technologies. The competitors are constantly improving extraction technologies and devising efficient ways of oil use to reduce dependence on imports.

Secondly, the demand is likely to remain low for a year or so. Forecasts for next year predict a fall in global demand of about 300,000 barrels a day. Lower demand will mean lower prices.

Thirdly, while Saudi Arabia, which is reported to have an estimated savings of $900b, can live by selling cheap oil for about a year, smaller producers dependent on oil for over 40% of their GDP like Venezuela, Nigeria and Algeria cannot sustain the battle. Their fortunes will fluctuate with the oil prices. They are likely to pump more crude oil on the market to maximise income, which will further reduce the oil price.

What should Uganda do?

Uganda should not be worried about what is happening because oil prices like those of our other exports like coffee, cotton, tea, tobacco or copper fluctuate. All we need to do is to create mechanisms to endure the storms. The option is value addition before export to maximise profits. Eventually oil prices will rise again.

Lastly, major economies of Europe, China, Russia and Asia Pacific are not consuming (or demanding) as much oil as their markets can absorb due to temporary economic downturns. They will recover and demand more oil.

Capital Markets Authority to license investment banks

By Samuel Sanya

The Capital Markets Authority (CMA) has embarked on a process to amend the CMA Act to enable it license investment banks as a means of enlarging the scope of products on Uganda's capital markets and increasing the level of activity in the Ugandan economy.

Investment banking will fill a void for advisory services in the Ugandan economy. This will be especially with the impending liberalisation of the pension sector and the growth of investment clubs, which will create large pools of funds that need to be profitably invested.

Charles Nsamba, the acting CMA communication and investor education manager, says the word 'bank' shall be replaced with 'house'.

"As it is, we are in the final stages of drafting the amendments. We are working closely with First Parliamentary Council to ensure that we get it through the process as soon as possible for Parliament and the President's approval," he told *Business Vision.*

"Ideally, we are looking at attaining efficiency and generally attracting more players within this business," Nsamba explains.

He pointed out that the CMA has involved the Bank of Uganda (BoU) in discussions to amend the CMA Act so as not to infringe on BoU's territory.

Brokerage companies such as Crested Stocks Securities have already expressed delight at the development and have included attaining investment banking licences in their 2015 business plans.

Arthur Nsiko of African Alliance Securities says granting CMA the rights to license investment banks will enable specialised regulation of investment banking in Uganda and this will benefit Ugandans.

"Demand for advisory services is on the rise in Uganda and the amendment of the CMA Act is a good thing. This is good for clients as specialised regulation will protect client interests," Nsiko explained.

On Tuesday, Umeme dominated proceedings with trades for 2.97m shares worth sh1.5b, Stanbic moved 1.9m shares at sh34 per share, and Uganda Clays moved 1.6m shares at sh20 per share.

Bank of Baroda traded 24,402 shares at sh118 per share, dfcu traded a paltry 200 shares at sh705 per share, while cross-listed Centum traded 128 shares at sh1,650 per share.

The all share index fell to sh1895.93 from 1918.89, while the local share index fell slightly to 318.8 from 318.63.