

## Price Swings

John Donnelly, JPT Editor • [jdonnelly@spe.org](mailto:jdonnelly@spe.org)



A new report from Ernst & Young seeks to find a bottom for commodity prices and any signs that might point to economic recovery. Among its findings are that the recent oil price fall was the steepest ever, at 75%, and that past price corrections have lasted an average of 73 weeks before recovering. Because recessions eventually have given way to economic resurgence that relies heavily on energy, the report concludes that now is the time for the oil and gas industry to prepare for economic recovery by continuing to drill, ensuring that it is retaining talent, and investing in alternative fuels.

Others have sounded a similar note of late. At last month's annual Cambridge Energy Research Associates (CERA) conference, executives from BP, Shell, and other firms noted the importance of continued investment in energy. Robust long-term growth forecasts for hydrocarbons have not changed, and the industry could be caught flat-footed when the recovery comes if it shuts down too much now. Shell Chief Executive Jeroen van der Veer said he believes that global energy demand still will double over the next 40 years, boosted by consumption from the developing world. BP Chief Executive Officer Tony Hayward also showed optimism. "The world economy will recover," he said. "The future is not canceled." (For additional reporting on the event, go to JPT Online at [www.spe.org/jpt](http://www.spe.org/jpt).)

The statements lend credence to the idea that many in the industry are trying to avoid some of the mistakes of the past, when R&D and staff were sharply cut in the wake of down cycles. But nothing paralyzes the oil market so much as price instability. After the steep drop in prices in the second half of last year, oil seemed to be recovering, only to fall again and remain volatile. Such unexpected swings deter decisions about investment, particularly those projects with sensitive price thresholds such as oil sands and unconventional.

Volatility also hampers merger and acquisition activity. Sellers are reluctant to shed assets at low prices while potential buyers continue to sit on cash. "Nobody has been willing to pull the trigger. Everybody has been waiting for the upside," said IHS executive Linda Kinney at a conference last month in Houston sponsored by the consulting firm.

Daniel Yergin, Chairman of CERA, says the oil markets "are suffering acute whiplash" and that the price volatility since mid-last year is causing confusion and uncertainty. The International Energy Agency says a shortage of capacity was really at the center of the steep run-up in prices that ended last year. Although "speculation" may have played a role, it was really the fundamentals of supply and demand that drove the market. Strong growth from places such as China and India exploited years of industry underinvestment in both the upstream and downstream, constraining supplies. It expects a similar tightness could occur in just a few years after the global economy fully emerges from what appears to be a severe recession.

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**Francisco J. Alhanati**, Director Exploration & Production, C-FER Technologies

**Syed Ali**, Research Advisor, Schlumberger

**Ibere N. Alves**, Senior Petroleum Engineer, Petrobras

**Baojun Bai**, Assistant Professor of Petroleum Engineering, Missouri University of Science and Technology

**David Barnett**, Vice President Engineering, Wild Well Control

**Peter Bern**, Senior Drilling Engineer, Shared Petrotechnical Resource

**Luciane Bonet**, Senior Reservoir Engineer, Petrobras America Inc.

**Simon Chipperfield**, Team Leader Central and Amadeus Gas Exploitation Development, Santos Ltd.

**Greg Conran**, Drilling Advisor, Schlumberger

**Martin Crick**, Senior Reservoir Engineer, Schlumberger

**Ivor Ellul**, Chief Executive Officer, Knowledge Reservoir, LLC

**Sam Gomersall**, Director, CO2DeepStore

**Harvey Goodman**, Research Consultant, Chevron

**Manuel Gonzalez**, Senior Engineering Advisor, Chevron

**Charles Hager**, President/Independent Consultant, NSI Technologies

**Damir Horvat**, Drilling Engineering Manager, Arrow Energy

**Jean-Louis Jousseume**, Head of Geographical Areas—Americas, Europe, and CIS, Total

**Anthony Kovscek**, Associate Professor, Stanford University

**Gregory Kubala**, Project Manager, Schlumberger

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**Stephane Menand**, Research Engineer, Paris School of Mines

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**Stefan Z. Miska**, Professor, U. of Tulsa

**John Misselbrook**, Director Global Coiled Tubing, BJ Services Company

**Alvaro F. Negro**, Deepwater Group Manager, Repsol-YPF

**Shauna G. Noonan**, Staff Production Engineer, ConocoPhillips

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**Marcel Polikar**, Senior Reservoir Engineer, Shell E&P Co.

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**Jacques Salies**, Well Engineering Manager, Petrobras America Inc.

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**John Veil**, Manager – Water Policy Program, Argonne National Laboratory

**John Vitucci**, Senior Project Manager, Doris Inc.

**Scott Wilson**, Vice President, Ryder Scott Company

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