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Natural Resources

Shale gas revolution ‘could halve oil price’

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The price of oil could halve within the next decade because of a shale revolution, according to industry experts.

John Llewellyn, the former head of international forecasting at the Organisation for Economic Co-operation and Development, said that most oil price forecasts underestimated radically the impact of new extraction techniques for shale oil and gas on supply.

Official estimates last week revealed that Britain was sitting on enough shale gas to power the country for 43 years, although it remains years from extraction. Cheap gas helps to lower the oil price and many shale rocks also contain oil.

In a report written with Puma Energy, the fuel business owned by Trafigura, Dr Llewellyn said that a shift taking place in oil markets between now and 2020 could reverse the significant change that took place in the 1970s, when the price doubled and the United States became a large net importer of oil. Oil costs more than $100 a barrel today.

"[That change] contributed importantly to the quadrupling of the world price of energy in 1973-74 and the further double in 1978-79. If, as expected, the US becomes energy self-sufficient over the coming 20 years, the shift could be equally profound," the report states.

One chief executive of a FTSE 100 oil and gas producer said that if shale gas did result in a long-term US gas price close to $5 or $6, that would equate to only $35 a barrel for oil. Even with a premium paid for oil being in a more convenient form than gas, that puts the likely future price of oil at a fraction of current expectations.

Dr Llewellyn called the development of fracking — whereby gas and, in more recent advances, oil, can be extracted by shattering rocks deep underground — a "game-changing" technology. The development means that an oil price of close to $50 a barrel — about half the existing price — was much more likely than the cost rising to $200 per barrel. Oil is very likely to fall to well under $100 by 2020, the report says.

This analysis is disputed by many in the industry. Tony Hayward, the former chief executive of BP who now runs Genel Energy, said that if oil prices were to fall drastically, some shale production would not be econ-omic, pushing prices back up.

The conviction that oil prices will fall also contrasts starkly with a long-term forecast published by the International Monetary Fund last year, which predicted that the price could spike to double present levels and would reach a minimum of $120 a barrel by 2020. The report sparked a revival of "peak oil" fears — the theory that the world was doomed to run out of oil.

Holger Schmeiding, an economist at Berenberg Bank, disagrees with Dr Llewellyn but said that if he was right, the effects would be profound: "One of the many reasons why the Western world is finding it difficult to recover convincingly from the post-Lehman financial crisis is that raw materials are expensive. If oil were to go to $50, I would not be surprised if, say, over the course of five years, Western economies' GDP would have room to expand 4 per cent more than otherwise."

Although oil importers would be boosted, a drop in oil prices would choke off bumper revenues for exporters, such as Saudi Arabia and Russia, which could cause major political shifts.

Pessimists believe that the price of oil could rise signficiantly if there is further unrest in the Middle East, with possible spillover effects from the turmoil in Syria.

In real terms, the price of oil is about 13 times what it was in the early 1970s, according to the OECD, although in nominal terms it is nearly 60 times higher.