Oil price puts pressure on biofuels

The oil price has slumped by more than half since June last year, forcing biofuel producers to cut prices as well. **Denene Erasmus** reports.

The oil price has been on a sharp downward trajectory since June last year, and at the time of going to print, economists have predicted that the local price of diesel will come down by about R1/ℓ in February.

Slow economic growth in the Eurozone and China had caused a decrease in demand for oil, but the reason for the decline was "more a tale of supply than demand", said Nicky Weimar, senior economist at Nedbank, at a VinPro information day in Cape Town recently.

Increased supply from Saudi Arabia, as well as increased shale oil production in the USA, had resulted in the latter emerging as a huge net exporter of oil, she said.

The oil price has declined 60% since June last year, benefiting net oil importing countries such as South Africa.

EXCHANGE RATE AND INFLATION

Domestic fuel prices are influenced by the international oil price, as well as exchange rate fluctuations. Although the rand had not performed well against the US dollar and other major currencies, oil was trading at such a low rate at present that not even a further weakening of the rand could prevent local fuel prices from falling, said Laura Campbell, economist at Econometrix.

Although the weakening in the oil price was in part a function of a strengthening US dollar, there was no comparison between the declining value of the rand and the magnitude at which the dollar price of oil had fallen, she said.

The drop in oil prices had had a ripple effect that greatly influenced other commodity prices.

THE OIL PRICE'S DECLINE 'IS MORE ABOUT SUPPLY THAN DEMAND'

As a result of low oil, fuel and commodity prices, inflation would "plunge over the next few months", but would pick up later in the year, she said.

The oil price was likely to recover to between US\$60 and US\$70 by the end of the year, she added.

BIOFUEL PRODUCERS STRUGGLE

The sharp decline in the oil price has not been good news for everyone. In the USA and Brazil, alternative energy sources such as biofuels have been taking a battering due to the low oil prices.

International news agencies have reported that US biodiesel producers are being forced to reduce prices and margins to remain competitive.

The local biofuels industry, however, did not expect lower fuel prices to have an impact on development in the sector. Biofuel production costs depended to a large extent on raw material costs, said Mabele Fuels general manager, Asogan Moodaly. The company aimed to produce 158 million litres of sorghum-based bioethanol per year, and grain sorghum made up between 70% and 80% of the total production cost, he said.

Mabele Fuels had not started construction of its Bothaville plant yet, as it was awaiting the enactment of biofuel legislation.

With the grain sorghum price fluctuating between R1 800/t and R3 200/t, the company needed to earn between R7/ℓ and R10/ℓ to remain financially viable. These figures included the price paid by oil companies as well as the subsidy received from government. The retail price of biofuels would in future be linked to the fuel price and determined by government, he said.

Latest biofuels legislation currently awaiting Cabinet approval proposes a dynamic subsidy scale whereby the government subsidy would increase or decrease, according to the cost of production.

However, South Africa would have to produce about 400 million litres of biofuel per year to meet the minimum 2% penetration blending level.

It seemed unlikely that the mandatory blending deadline of 1 October 2015 would be met, given the delay in finalising the industry's legislative and regulatory framework. But Mabele Fuels remained confident that the regulatory process was close to being finalised, and the various parties involved in biofuels should not see the current low oil price as a reason to abandon many years of hard work, said Mabele Fuels CEO, Phil Bouwer.

BELOW: SA's biofuel industry is awaiting the enactment of legislation to start with the construction of production plants.
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