Portland market report

January update

As we welcome a new year (2014 sounds a bit Buck Rogers to this writer…), the lifting of certain sanctions against Iran, remains the dominant issue for market analysts trying to forecast where oil prices will go over the next 12 months. Understandably at the time, (when the announcement was made in November), it was geo-political implications that dominated the headlines, but it is only now that the market is getting to grips with what fresh Iranian oil might mean to world supply and demand and therefore prices in 2014.

Even though sanctions against Iran's "uranium enriching programme" were first applied back in 2006, it was only at the beginning of 2012 that oil exports were included - such was the fear in the West that a shortage of oil (and consequent price rises) would detrimentally affect the feeble world economy. And the facts surrounding Iranian oil production would suggest such fears were well founded. With 151 billion barrels of oil under the ground, Iranian oil makes up almost 10% of the world's reserves. Up until 2011, the country was the second largest oil producer in OPEC with 3m barrels per day (bpd) and at the time, memories of the 2011 Libyan crisis were fresh in people's minds (where a reduction of 1.4m bpd caused a $15 per barrel price increase). In fact, many in the West were convinced that any reductions to Iranian oil supply would be nothing short of economic armageddon.

THE CUSHION OF OIL PROVIDED BY SAUDI ARABIA ENSURED THAT PRICES IN 2013 WERE ACTUALLY LOWER THAN 2012

Therefore it was a courageous move to introduce the draconian sanctions of 2012, although by then, most western politicians knew that only sanctions on "black gold" (making up 80% of Iran's GDP) would have the desired effect on Iran's leaders. Plus the decision was made significantly easier by a Saudi Arabian announcement at the time, which made assurances that their spare production capacity (almost 4m bpd – more than total Iranian production) would be made available to help ease market fears. Consequently, there was no economic armageddon and in fact the cushion of oil provided by Saudi Arabia ensured that prices in 2013 were actually lower than 2012. Saudi involvement in the whole affair also ensured one further thing: undying enmity from Iran, who correctly concluded that the offering of spare capacity was the single decisive factor that emboldened the western leaders to apply more severe sanctions.

WILL THE RENEWED SUPPLY OF IRANIAN OIL LEAD TO A DROP IN FUEL PRICES?

But as we go into 2014 and with sanctions now easing off, the logical question is whether the renewed supply of Iranian oil will lead to a drop in fuel prices anytime soon. Certainly, the extra supply must ease price pressure (there can be no doubt of this), but punters waiting on a large-scale and immediate drop in prices will be disappointed. Firstly, there is the obvious fact that Iran is a long-way from normal acceptance into the international community and any misdemeanors on the way to redemption will be heavily punished. Secondly, the 2012 embargoes - although more successful than previous sanction programmes - were far from universally applied, as is often the case with western backed sanctions. Countries like India, whilst condemning the Iranian regime and agreeing to sanction non-essential goods, were simply not in a position to cut off oil supply from a country which provides 15% of Indian energy. Likewise, Chinese economic policy will always take precedence over world politics (and opinion), so even when the sanctions were in place, Iran was able to continue exporting up to 70% of its oil (almost 2m bpd) eastwards.

So we should not expect Iranian oil to flood the markets in 2014, as much of it is already on the market. Plus political expedience in the West will mean that those wanting to buy Iranian oil must proceed with supreme caution and this means that product will return only in dribs and drabs rather than all at once. We also have the classic price versus volume conundrum for the Iranians to consider. Of course they will want to see greater volumes coming out of Iran, but not at the expense of falling prices affecting income from existing sales. In fact, a significant drop in crude price would be ruinous for Iran, particularly in the early stages of 2014, when production and volumes will not have recovered to pre-2012 levels.

Finally, there are many commentators and politicians from countries as diverse as Canada, Israel and Saudi Arabia, who say that this latest gesture from Iran is merely a stunt to buy some time. These states maintain that the rules around Iran's uranium enrichment will (once again) very soon be broken and inevitably, supply constraints will have to be re-applied. At that point, we should expect any short-term benefits since the easing of sanctions to rapidly vaporise and prices could head northwards once again.

For more pricing information, see page 26

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