PORTLAND MARKET REPORT

July update

Half way through the year already! The nights are already drawing in, so no better time for a mid year review of the oil markets! By most standards, the first 6 months of 2016 have been fairly remarkable in oil terms. "What's that? Have you not noticed that the oil price has doubled in 6 short months?!" Maybe it's because a $50 per barrel price still seems unremarkable versus the highs of the recent past, but imagine if house prices had doubled in the same period. Or cars? Or even a loaf of bread? It's fair to say that if we'd seen such huge price rises on any of those products, there would have been a great deal more attention than we have had for the oil price rise, which has barely elicited murmur from the assorted commentators.

So what is going on? Well to some extent what we have seen is a rebalancing of supply and demand and an oil market that (through its recent price movements), has recognised that the fall in the value of crude in 2014-15 was probably overdone. In spite of the usual clownish predictions from the banks ($10 a barrel anyone?), the fact is that $25 per barrel probably was too low a price to last for long. In the States – to a backdrop of cheers from OPEC - the drillers did start to go bust at the beginning of the year and the production figures bear witness to this fact. From 2010 to 2015, US oil production rose from 6m barrels per day (bpd) to 9mbpd. But in the first half of this year, that figure has dropped to 8m, meaning a full 10%+ of US production has been taken off the market. At the same time, the massive supply disruptions in Nigeria are beginning to bite, with estimates of between 300-500K bpd being stolen by Niger Delta rebels (the largest group calling themselves the Niger Delta Avengers – a comically ridiculous name for a no doubt terrifying set of people in real life).

However, to counter these major drops in oil production, we do have the rapid increase in oil production from Iran. Experts had estimated that it would take more than 12 months for Iran to get back up to its pre-sanction production levels of 4m bpd, but in fact it has taken less than 3 months and this has added a whopping 1.2m bpd onto the markets. So far so balanced then. Take the extra 1.2m barrels from Iran and then take off the reductions in the USA (1m bpd) and Nigeria (0.4m bpd) and things look pretty even. In fact there is a slight negative supply imbalance (-0.1m bpd), although this has to be viewed in the context of a market that was already glutted with oil. But hold your horses…what about demand? Doh! We now need to factor in an increase of 1m bpd consumption in from January to June, because for the final time, demand for oil is increasing every year. Now the maths looks decidedly different, with supply/demand showing a negative 1.1m bpd position and that is easily enough to push prices back up quickly since the beginning of the year.

> OIL PRICES 2016/17 – 'EXPECT SIGNIFICANT VOLATILITY BETWEEN A $25 AND $75 RANGE'

So what can we expect for the rest of the year and then going into 2017? Well at the current juncture, a good metric is what Portland calls the "$25 - $50 - $75" rule and it's pretty simple. At $25 per barrel, oil exploration becomes commercially unviable in most forms and production stops (with many producers going bust to boot). This takes product from the market and prices start to push up. At $50 a barrel, supply and demand start to balance out and if this status quo could be maintained, both producers and consumers would be satisfied (consumers more than producers of course!). But that's not how markets work if worldwide demand for the product in question is constantly increasing. Pressure starts to build and prices continue to rise to the point where prices are attractive enough for production to accelerate. The charge for more oil will of course be led by the shale oilers, who don't need long lead times to get cracking again. Indeed the most remarkable facet of shale drilling is its seeming ability to start and stop without fuss (almost like switching a light-switch on and off) and whilst the rigs may be idle now, they will soon be dusted down, ready for action. And don't trouble yourself with the question of who will be there to do this work when so many shale oil companies have gone bust. As has been said on many occasions, low prices can bankrupt a company but they cannot bankrupt a technology. If it is not to be the previous shale oil driller, it will simply be another new one. The genie is out and when the price is right, shale oil will return. When that happens, we will experience another glut in supply and this will push prices rapidly downwards – probably to around the $25 mark where the cycle can begin all over again…

In short, expect significant volatility between a $25 and $75 price range. Producers would be foolish to hold out for the heady days of $100+ per barrel but nor should consumers expect prices to fall below $25 or even stay at that level for any prolonged period of time.

For more pricing information, see page 22

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