Portland market report

THE MANY AND DIVERSE NEW PLAYERS IN OIL PRICING ARE IN FACT COMPANIES THAT NOBODY HAS EVER HEARD OF

June update

With oil prices remaining stubbornly high, the banking crisis still fresh in people's minds and gas companies routinely accused of price fixing, it is hardly surprising that oil companies have once again, come under the microscope. The news that EU investigators have raided oil company offices in London and elsewhere means that this is now the 3rd Portland report on the subject of price manipulation in the last 12 months (see FON July 2012 and October 2012).

Details of the exact nature of the enquiry remain sketchy, but this has not stopped the media reporting in lusty detail on events. The argument goes that published oil prices (based on trading activity and used to set retail prices on the forecourt) are being manipulated upwards and the general public is carrying the consequent cost burden. The main tenet of this argument seems to be that there are inconsistencies in the price of crude and the price of refined oil products (ie, petrol and diesel). Well let's be clear here, crude and product markets are, always have been and should be, separate entities. In a quest to simplify the situation, the press consistently overlook this point, but contrary movements in price – although unusual – are entirely normal and reflect the different dynamics of supply and demand in each separate market (crude being a world product and products representing the more localized European market). So we should not be surprised that for example, on 9th May, Brent Crude prices fell whilst petrol prices went up. And three working days later (14th May), crude prices rallied, but diesel prices dropped. In addition to this, there are plenty of traders who only focus on refined products and never trade crude (and vice versa), so why should BP and Shell aim to connect these two separate markets just because they operate in both? Wouldn't that just put them at a disadvantage versus those who specialise in one market only and never seek to create a crude-product correlation?

The inquiry also runs the risk of disappointing the general public when the scale of possible manipulation becomes clear as what might seem large price movements on the traded market, will be small by the time they equate to consumer prices. Significant price discrepancies of $2-3 per tonne might be relevant to those buying and selling 25,000 tonne cargoes (ie, a financial discrepancy of $70K on one sale), but would we have such uncompromising media coverage, if it was made clear that this amount equates to 0.10 pence per litre (ppl) at the pumps? It is true that systematic abuse by the oil companies over many years, could mean 0.10 ppl being multiplied many times over, but such a conclusion is predicated on a handful of major oil companies being able to systematically manipulate hundreds of bulk oil transactions (Rotterdam barges) daily, involving up to 40 separate buyers and sellers daily.

IT IS QUITE POSSIBLE THAT PRICE MANIPULATION (IF IT DOES EXIST) COULD RESULT IN PRICES FALLING

"Back in the day" of course – before the commodity boom – the likes of BP, Shell and Exxon *did* dominate the markets to a much greater extent, but these oil majors now control less than 20% of the European oil market. The many and diverse new players in oil pricing are in fact companies that nobody has ever heard of (Vitol, Gunvor, Mercuria, Lukoil), so if the EU needs to start their investigation anywhere, shouldn't they looking at where the product in Europe frequently comes from, ie, Russian imports traded by Russian and International Traders? An EU probe into the Russian oil companies would not get very far of course, because…well, firstly they're Russian and secondly, they have based their European operations in Switzerland – a country outside the EU's jurisdiction and a place not usually known for its open-book approach to financial and commercial transactions. And here's us naively thinking that the Russian companies based themselves there because they liked chocolate, cuckoo clocks and going to bed early…

Finally, it is quite possible that price manipulation (if it does exist) could result in prices falling. A quick look at what makes up the oil trading community would demonstrate this, with approximately 30% of oil trades being carried out by investment banks. With no inventory to play with, these institutions have no vested interests in prices going up. When the casino traders (as St Vince likes to call them) "bet" on the market, they are just as likely to wager on prices falling (*going short*), as they are to be betting on prices going up (*going long*). Furthermore, it is entirely logical to say that the likes of BP and Shell will actually sometimes benefit from these price falls because of the nature of their production portfolios. The majors all have greater demand for diesel than petrol in Europe but cannot produce enough diesel to meet that demand. So they end up selling large volumes of petrol to the USA (thus not directly affecting European consumer prices anyway), whilst having to buy their diesel from Russian importers. It would be a strange world indeed if BP and Shell were manipulating prices upwards, just so they could pay more money to the Russians!

So when the raids and investigations are complete, the general public will be no more satisfied than they are now. Expectations will have been raised, but the price of fuel will remain at circa 50ppl, government duty at 60ppl and VAT at 20ppl. Sure, if the EU Commissioners look hard enough, they will no doubt find examples of oil traders screwing each other over, but our guess is that there will be little that is systematic about their behaviour, the price movements will not be of a scale that is material to the consumer, prices will have just as likely been pushed downwards as upwards and finally, the investigators will conclude that the crude oil market only indirectly relates to the price of refined petrol and diesel.

For more pricing information, see page 26

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