Portland market report

VERY FEW MARKET OBSERVERS PREDICTED ANYTHING LIKE THE MAGNITUDE OF MARKET MOVEMENT EXPERIENCED IN OCTOBER

November update

At the beginning of this year, a so-called "expert" on oil prices predicted the following (in this publication): "punters waiting on a large-scale and immediate drop in prices [in 2014] will be disappointed". What a plonker! Urm…hold on a minute…that was me…. DOH! Everyone makes a mistake I suppose and Portland was certainly not alone in being caught out by the recent price drops. In fact very few market observers predicted anything like the magnitude of market movement experienced in October and most were caught red-faced and flat-footed – just like Portland!

First the stats – the price drops we witnessed in October were certainly significant (sometimes over a penny a day and reminiscent of 2008), plus they were coming on the back of a more steady decline in prices that commenced just about the time Portland made his bold prediction (see attached graph). The next question is "Why" (?) and there are two broad schools of thought on this; one concerning demand and the other focusing on supply. The demand argument is that the world economy is grinding to a halt, Chinese oil usage is slowing and therefore the brakes are being put on oil consumption. Add to this economic slow-downs in Brazil, India and the spectre of Eurozone failure rising from a (very shallow) grave and you have both a dramatic and gloomy picture. A picture also very much loved by the press and media, who as we know love nothing more than a good scare story.

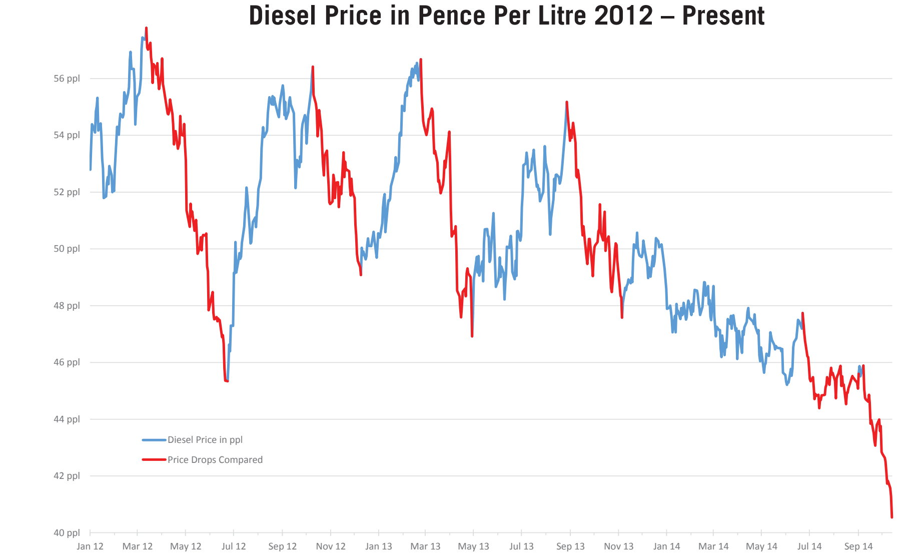
But oil consumption is not actually falling. In fact oil demand continues to increase - just not at the same rate as a couple of years ago. In theory such a slow-down in demand growth should only mean that price rises are tempered rather than the wholesale fall in prices that we have experienced. So we have to turn to supply to explain the situation and it is here that we have the key (according to this so-called "expert") behind the price drops.

Quite simply, the world is currently awash with oil – far more than the current rate of demand growth requires – and this situation has been slowly building over the last 12 months. Oil production is buoyant wherever you look. Despite socio-political problems in Russia, Libya and Iraq, all of these major players are actually producing more oil now than they were in 2014. The dropping of sanctions against Iran at the end of 2013 has ensured their oil has also now joined the party and the biggest game changer of all is of course the glut of North American shale oil. All these factors combined mean that in September 2014 the world pumped about 3m barrels per day more oil than in September 2013. That's about a 4% increase on world oil production in 12 months, a statistic that makes the Peak Oil theory that was fashionable a few years ago seem rather ridiculous.

Talking of outlandish theories, Portland has also read that the real reason behind the price drops is that the USA and Saudi Arabia are manipulating prices downwards (by flooding the market with cheap oil), so as to hit Russia and support the sanction programme surrounding the Ukraine crisis. Many in the tw*ttersphere will no doubt believe this, but generating such self-inflicted pain is surely OTT for the Saudis (although there will probably be some private glee in Riyadh to see the hated Iranians - rather than the Russians - suffer at the hands of lower prices). Of more significance to this theory would be the USA, but despite what conspiracy theorists believe, decisions on oil pricing are not made in the White House. They are made instead indirectly by the hundreds of independent oil producers in Dakota, Pennsylvania and Texas who have no interest in grand geo-political games. Over the last 12 months these guys have gone into overdrive, pumping millions of newly discovered barrels out of the ground and this has pushed prices down. But having enjoyed sales above the $100 mark and having invested millions of dollars to get the shale wells up and running, the drop in price to $80 per barrel will have come as a very unpleasant surprise. Furthermore it's more than possible that if prices fall even lower, returns may start to become insufficient, particularly if the operators have borrowed to fund the original prospecting costs. Thus whilst it is still too early to declare the end of the shale oil miracle, lower prices may well signal the end of the boom phase and a drop off in production would be the logical result of this.

What then for prices you ask? Well don't ask me…I'm an "expert"!

Diesel Price in Pence Per Litre 2012 – Present



For more pricing information, see page 26

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