PORTLAND MARKET REPORT

"OIL MARKETS ARE ONCE AGAIN TEETERING ON THE EDGE OF A MAJOR PRICE SURGE"

July update

As we reach the mid-year point of 2019, let's consider how oil markets have fared since the beginning of the year and let's also see how Portland's 2019 prediction of a $65 per barrel oil price is looking.

When we put together our January 2019 report, we were fairly confident that having crashed massively in Q4 2018 (down $30 per barrel), oil prices were unlikely to fall any further. In fact, prices didn't just stabilise, they seriously bounced back the other way. At the start of the year, Brent Crude was trading at $53 per barrel and by the end of the first quarter (March 31st), oil had reached $68 per barrel. However since that point, markets have struggled for direction either way and have largely remained around the mid $60's mark.

The reasons for the rapid correction upwards in Q1 were fairly obvious. Ongoing demand growth from India and the Far-East created a largely bullish air (prices up) and this demand-driven backdrop was coupled with 2 key factors on the supply side; continued discipline from OPEC in maintaining production cuts and Venezuela's worsening (if that were possible) economic situation.

Historically, production cuts by OPEC have been poorly maintained, with public declarations ("we will now cut production") not matching operational reality ("let's maximise production to take advantage of rising oil prices"). But this time around, OPEC's restraint has been impressive and almost all members of the cartel have stuck firmly to their allocated quotas. In addition, the biggest player of all has actually constrained production below targeted levels, with Saudi Arabia producing only 9.8m barrels per day (bpd) in April, even though the country is permitted to produce 10.3m bpd.

Venezuela's production woes are calamitous and probably worthy of an update since the last time we looked at this country (see Fuel Oil News April 2013 edition). The South American oil giant is the world's longest established oil producer, has 20% of proven global oil reserves and is an OPEC member. Despite having a production quota of 2m bpd, such is the desperate state of the economy (and the oil industry within in), that volumes this year have dropped to below 400,000 bpd. Frequent electricity power outages are shutting down production facilities on a daily basis, whilst refineries stand idle waiting for maintenance and new parts, that can no longer be afforded. Product embargoes prevent export flows, whilst those ships that are permitted to trade with Venezuela are struggling to get alongside silted-up jetties that have not been dredged for months on end.

"ANY DISPUTE BETWEEN IRAN AND THE USA WOULD HAVE SEISMIC CONSEQUENCES ON OIL PRICES"

These then were the clear bullish factors in the market, that made a Q1 price recovery inevitable. Holding things back once the price got to around the $65 mark, was the steady return of US shale oil and the on-off US-Sino trade war. Shale oil production has certainly been rising steadily in the USA and previous over-capacity in this area has generated massive price crashes (2014). But as our January report pointed out, many shale operators remain heavily in debt and struggling to meet operational costs, which is naturally curtailing the scale and speed of production growth. As for the trade war between the USA and China, this clearly has spooked oil markets, because any downturn in global trade would obviously reduce oil consumption. But it does remain almost impossible to make firm predictions on this one, because so much depends on the individual and often erratic actions of US President Trump. Probably the safest conclusion is that neither the USA nor China want a fully-fledged trade conflagration and therefore once symbolic penal tariffs have been placed (and counter-placed) on flag-ship industries, then business as usual for the vast majority of "under the radar" trade will continue as normal.

If that was the case then there would be few downward drivers of prices left, just as one massive upward factor is now rearing its very ugly head. Surprisingly few column inches have been taken up by the looming potential conflict between Iran and the USA (such is our obsession with Brexit), but any dispute between these two countries would have seismic consequences on oil prices. The main reason for this is the Straits of Hormuz, which has a full fifth of the world's oil consumption (not to mention around 30% of the global Liquefied Natural Gas trade) travelling through it.

This bum-squeakingly tight shipping lane provides only 6 miles of navigational width for vessels, which is pretty narrow when you are captaining one of the 30 ships that navigate the straits daily – some of which are over 400m in length. A blockade of the straits by Iran would send prices sky-rocketing and as a comparative example to illustrate this point, 2011 civil unrest in Libya removed 2m bpd from global oil markets. The result was a spike in oil prices from an already inflated $90 per barrel to an incredible $126. Removing 20m bpd from global markets isn't even worth thinking about, but suffice to say that oil markets are once again teetering on the edge of a major price surge. For the moment, there is just about balance between signals of a bearish (trade war) and bullish (actual war) kind. But as the prospect of one recedes, the prospect of the other is advancing and until tensions are eased in the Middle East, an eye-watering price escalation remains a distinct possibility.

For more pricing information, see page 26

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