PORTLAND MARKET REPORT

JANUARY IN VIEW

MAKING BOLD PREDICTIONS FOR 2021

Let's face it, the new year has hardly started off in a way that any of us would have wanted! Nonetheless, we soldier on, and this month we will look back over the last 12 months and then make some bold(ish) predictions for 2021. The first thing to say is that this time last year nobody really had a handle on how bad things were going to get in 2020, although Portland was predicting a drop in the oil price. We stated that the "oil market was in a bearish phase" and that "excess US oil production, alongside reduced global demand were recipes for drooping (sic) prices in 2020".

This means we got the basic idea right but, as any oil trader will tell you, predicting the general direction of travel (up or down) is the easy bit. To make money, you need to predict the scale and speed of movement. And here we were way off – alongside every other oil analyst, investor and operator. At London Oil Week ("IP Week") back in February, despite several high-profile and last-minute cancellations, the virus

"ONE CRAZY DAY ON THE OIL MARKETS IS NOT NECESSARILY A WINDOW ON THE FUTURE"

was still not seen as a long-term threat to the oil market. Nor did anybody at the time predict that a pricing war between Russia and Saudi Arabia would swamp the market with oil, just as demand was falling off a cliff because of the pandemic. We are also absolutely 1,000% confident that not one person anywhere in the world could have predicted 12 months ago that the oil price would drop to minus $37 per barrel. Which, of course, it did on April 23rd.

The tenure of this extra-ordinary event was short-lived and the circumstances as technical, (pipeline and tankage capacity in Oklahoma) as they were market driven. Plus, apart from a handful of Chinese Hedge Funds (one of which was completely wiped out), there is scant evidence that this freakish event caused sustained commercial damage to either operators or (non-speculative) industry investors. Nonetheless, the significance of negative oil prices should not be under-estimated and, although few will publicly state it, the event has spooked investors and oil company shareholders, because of the precedent now set. Conventional and long-held wisdom is that commodities always have a residual value – that is what makes them attractive for investment. Even at below $10 per barrel, there is still a market for oil and with efficient processes and the right supply-chain, there is money to be made somewhere. But a minus oil price (potentially sitting alongside negative interest rates), possibly for a prolonged period of time rather than just one day? No thank you! And, whilst one crazy day on the oil markets is not necessarily a window on the future, it may have been an insight into a low carbon world, where oil producers are desperate to keep volume coming out of the ground, whilst oil demand steadily declines in the face of renewable fuels.

The jury is probably still out on that one, but what we can say is that the price race to the bottom has been devastating for the Petrostates, the US shale industry and the major oil companies. The chaos surrounding OPEC's decision making in the first half of the year not only highlights how misaligned member states are, but also just how much pressure they were under. OPEC countries typically require oil prices at $75+ to balance the books and their ongoing oil growth assumptions look increasingly out of kilter with a decarbonised world. US shale is facing its own day of reckoning with the number of oil rigs already having halved in 2020 and the spectre of $20bn of debt that will mature in 2021. This will either have to be repaid (no chance) or re-financed (somehow). As for the oil majors, they have either faced the ignominy of sliding out of the public eye (Exxon Mobil were ejected from the Dow Jones Industrial Average, having been a member since 1928) or are desperately trying to convince wary investors of their green credentials and plans for a renewable future (like BP). One thing is for sure, none of them are heralding new or existing oil exploration projects.

But here's the thing, whilst there is largely agreement (outside of OPEC) on the fact that global oil demand will decline much sooner than previously predicted, immediate demand is beginning to recover, particularly in China and South-East Asia. As that demand is gradually ticking back up from pandemic lows, supply on the other hand continues to collapse. Investment in oil exploration and production is down by 30% globally and 40% in the western economies. Furthermore, there is no operational mechanism that can switch supply back on quickly and nor is there much financial appetite for re-investment in old school oil projects.

"A RECIPE FOR SIGNIFICANT AND SUDDEN PRICE INCREASES"

Which is why we predict that prices will go up in 2021 and even see the possibility of a major price spike, as the gap between supply and demand becomes critical. That isn't to say that we see a long-term recovery for oil prices, but we do easily see another year of significant price volatility, only this time in an upwards direction. If we assume modest economic growth over the next 12 months, then there is clearly the possibility of inadequate supplies of oil being in place to help fuel the recovery. It must also be recognised that renewables are still several years away from being able to fill the gap. Such a scenario would be a recipe for significant and sudden price increases, although of course the coronavirus still may have the final say and blow all our predictions way off course. We may be tired of covid, but sadly covid may not yet be tired of us…

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