PORTLAND MARKET REPORT

JANUARY IN VIEW

PREDICTING THE UNPREDICTABLE: OIL PRICES PAST AND FUTURE

It's the new year so time for our annual review of the last 12 months, with some forward-looking predictions thrown in for good measure. In last year's report we once again correctly predicted the direction of oil prices and indeed the scale of those price movements – even without the reckoning of the Ukrainian invasion (which no-one predicted). Nonetheless, we still forecast brutal price rises and the strong likelihood of a major price spike: "We can say that the supply-demand situation remains critical and in fact the danger of a major price spike looks more likely this year than it did in 2021". We pointed out that declining investment in oil production, coupled with rapid post-Covid demand recovery was putting huge pressure on prices. We also drew attention to the incredible situation with regards gas, which by January 22 (again, before the Ukrainian invasion) was already trading at stratospheric levels. We projected that this would encourage major energy users to switch away from gas (to oil), thus putting more pressure on the price of crude.

"DIESEL: THE STAND-OUT FUEL STORY OF 2023"

With a backdrop like that, it was little wonder that, when Russia invaded Ukraine, the effect on oil markets was seismic and crude had touched almost $140 per barrel by March. However, if we actually consider the year as a whole, rather than the crazy months of the spring, the overall price trajectory of oil – whilst broadly in an upwards direction – wasn't perhaps as spectacular as might be assumed. On the first working day of 2022, the price of crude was $77 per barrel and, yes, by March it had risen to $138. But, by the final quarter of the year, prices were trending heavily downwards, such that, by the final working day of last year (30th Dec 2022), the price was actually 'only' $86 per barrel – an inflation-matching increase of 12%.

The devil, however, is always in the detail and the $ price of crude only tells a fraction of the whole story. The first factor that ensured the Great British public experienced more than a mere $9 per barrel movement, was our old friend the exchange rate. Everyone knows the drill by now; oil is priced in $, which means it has to be converted to £ when it is sold in the UK. On the 30th December 2022 (end of last year), the price of diesel was $958 per tonne and the exchange rate was $1.2029 to the £ GBP. That gave a price of £796 per tonne and a pence per litre (ppl) cost of 67.32. Now compare the year-end exchange rate to the same day 12 months earlier (30th Dec 2021), when there were $1.3544 to the pound. If we applied that 2021 exchange rate to the 2022 price of diesel ($958), we actually would have ended the year at £707 per tonne (958/1.3544) or 59.79ppl. That's an increase of 7.50ppl (+10%) as a result of the falling value of sterling, which has to be added to the basic 12% increase in the core cost of crude.

"And there's more." (Jimmy Cricket, ITV, 1985-88). If there was one stand-out fuel story of 2022 it was not the cost of crude, nor the crashing value of the pound, but the soaring price of diesel. Whilst market commentators are often fixated by crude (which actually only directly affects refineries), it is the finished products that matter most to consumers and the price of diesel, above all else, which has most impact when it comes to the cost of living. And here again we had extra-ordinary movements in the price. Diesel started 2022 (4th Jan) at $677 per tonne and, therefore, logically should have ended the year around 12% higher ($760) if it had followed the same trajectory as crude. Imagine the scenes when it turned out that diesel ended the year over 40% up at $958 per tonne which, when added to the exchange rate impact, gave (for the UK at least) an increase of 25ppl (60%) in the price of diesel. That certainly boots the paltry $9 per barrel crude increase well and truly out of the stands!

This brings us nicely on to our predictions for the new year, with number one being that there will be much greater focus in 2023 on refined fuels and, in particular, diesel. Prediction number two is that for the first time since the Ukrainian invasion, Russia will begin to feel the pinch of sanctions and this will also be diesel-related. Whereas the Western boycotts of Russian crude in 2022 simply reversed product flows away from Europe and into China and India, this will not be the case with Russian diesel – which will receive the strongest sanctions yet as of February of this year. The Asian economies all need crude to keep their refineries running. What they don't need is ready made diesel from Russia, which would undermine Chinese and Indian refining capacity. In effect, Russian diesel will have nowhere to go and will be removed from the market – in the West because of sanctions and in the 'East' because of refinery protectionism. As a result (prediction three), we can expect a major diesel spike in the first half of 2023, along with a decimation of the Russian refining industry (prediction four). Our next prediction is that, once again, the correlation between diesel and crude will evaporate, but this will be short-lived as non-Russian refining capacity ramps up and soon fulfils demand. By the second half of the year, diesel will start coming down in price and re-correlate with stabilising crude oil prices. And that's our final and most bold prediction for 2023, which is that crude will be lower in price this year than in 2022.

"DECIMATION OF THE RUSSIAN REFINING INDUSTRY"

Oh…one more. Energy markets this year will not be boring. They never are!

For more pricing information, see page 38

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