Oil Market Report – June 2012

As prices continued their rapid descent throughout the month of June, there was a renewed debate in the industry as to the long-term prognosis for the price of oil. Yes the current drop in prices was significant (15 consecutive weeks of price falls) and of course they reflected the dire state of the world economy. But one day, the crisis will end, growth will return, unemployment will start to fall and oil prices will rise again. Or will they?

Portland has long held the view that cheap oil prices in a world of 7 billion population is incongruous. After all, so many people needing transportation, heating and power can only lead to price rises. This theory has been well-supported by many respected bodies and lead amongst them is the International Energy Association (IEA). They have produced several statistical reports showing how China's growth will starve the world of cheap fuel and generate continually rising oil demand every year until 2035. Supporting national forecasts for China, such as a threefold increase in private vehicle ownership, a 250% increase in passenger air traffic and the building of 50+ power stations per annum, all convincingly support the theory that prices will rise over the next 20 years.

However, for the first time, there are now some dissenting voices. Both the Ricardo Consulting Group (part of Ricardo plc) and BP's Statistical Review have suggested that Chinese demand may start to tail off after 2020 and may even end up decreasing by 2025. The revisionists say that the previous supply and demand forecasts have taken no account of the Shale Gas revolution, which in the space of 18 short-months has completely transmogrified (is this a word?) the natural gas market. In addition, optimistic forecasts for Shale Oil (previously a bi-product of the gas, but now a product stream in its own right) also have the potential to smash the status quo. So whilst there is little disagreement for example, on the fact that worldwide car fleets will rise massively over the next 20 years (estimates range from 50% to 80% increases), there is some debate around how many of these cars will actually be powered by conventional fuel. Instead, many could be powered by natural gas or fuel derived from non-conventional oil sources or even the old favourite, biofuels.

It is fair to say that biofuels, along with the renewable fuels sector in general, have taken a virtually mortal beating over the last 5 years, as economic reality has gripped the developed economies. Many of the more outlandish renewable projects were forced back into never-never land, where they probably should have always remained. But biofuels will bounce back – too much political and financial capital (particularly in Europe) has been invested in this area for it not to be so. Plus of course recovery brings optimism, and memories of rapidly rising oil prices will provide the perfect backdrop for a renewed effort to move away from oil dependence. Add to that the continued improvements in engine technology, car sizes and car weights that are both decreasing, plus a steady rise in the use of public transport and you have strong ingredients for a steady decline in oil consumption – in the West at least.

But for all of the above, there are still 7 billion reasons why oil prices will continue to rise in the medium and long-term. When the recession ebbs away, the price of oil will rise and predictions around ever increasing demand remain more accurate than not. But do avoid the hype – wild predictions on price super-spikes (mostly from our genius bankers) are unhelpful and quite probably wrong. There are many opposing price factors in the mix, which whilst not significant enough to keep the cost of oil at a low level, should at least be able to keep things in check.