Oil Market Report: January 2018

Here we are at the beginning of another year, which must mean it's time to get out Portland's Oil Price Crystal Ball! Before that though, let's look at what we predicted in January 2017 and see how our forecasts fared. This time last year, we said that "most pointers indicated another year of price rises" and that we would see "a consistent edging up of the cost of oil to $65 per barrel". Oh yes! The average price of oil in December 2017 was $63.94 per barrel and by the final day of the year (Dec 29th), it had reached $66.87 (cue huge applause, award for Best Oil Company in Central York and a spike in new-born babies called Portland). This also means that Portland has correctly forecast the price of oil for the last 3 years in a row and hopefully finally buries the calamity of 2014. Back then we said that prices would be "generally stable", a forecast that turned out to be around $75 a barrel out...!

But where are things heading in 2018? Conventional wisdom would tell us that oil prices tend to be cyclical - therefore for each month of rises, the likelihood of another major price crash also increases. However as things stand, our perception is that whilst a downward revision may be inevitable at some point in the future (2019?), prices are not ready to fall just yet. The main factor here is the ongoing inability of the shale industry to move as quickly as it has done in the past. Many of the original shale operators from the 2014-15 price crash have already gone bust and replacement companies have only slowly been filling the void. And of those original companies that managed to survive 2014-15, virtually all are significantly in debt, having borrowed heavily to stay in business. In this light, the raising of interest rates by the US Federal Reserve on two separate occasions in 2017 (by a total of 0.5%) was hardly welcome news. Effectively it doubled debt repayments for the shale operators and clearly curtailed both the production on existing wells and any plans for the drilling of new wells.

It is also worth noting that back in 2014, the shale industry was a notable bright spot in the US economy. But things are different in 2018, with the US economy booming across the board and this means that shale now has to compete with other sectors for both investment and labour. On the cash side, this presents a "double-whammy" effect, in that not only does it cost more to borrow (because of higher interest rates), but getting the cash in the first place is that much more difficult. For lenders and investors, non-oil parts of the US economy now offer lower risk, potentially greater and certainly less cyclical prospects for growth. To add insult to injury, non-oil is now luring shale oil workers with jobs that are well paid, more secure and invariably less harsh in terms of working conditions. No wonder that pay rates within the shale industry increased by 20% in 2017 to meet this challenge - a trend we see continuing in 2018.

All of which means that we have to rule out shale as a major factor in pushing prices back downwards in 2018. And it is difficult to see how conventional oil exploration will do that job either, particularly following OPEC's decision to maintain their production cap throughout the year. As for non-OPEC volume and the Oil Majors, much of their focus has already (permanently?) switched from oil to gas and to a lesser extent, renewables. Plus we know that conventional oil exploration requires long-term financing and that since 2014, investment in traditional oil projects has fallen annually by 25%. Put simply, in the recent low price environment, the focus of Big Oil has been on cost-cutting and not new projects.

So it seems that no sector of the oil industry is able or desirous to increase production and send prices southwards. In the period 2014 – 2016, it was supply and not demand that dominated the oil price landscape. But demand was the dominant factor in 2017 and we predict that this will be the case again in 2018. Last year the world consumed more oil (97 million barrels per day) than in any other year in history and that record will be broken again in 2018 (with a further increase of circa 2m barrels per day). These annual increases in demand are nothing new - global oil consumption has gone up every single year since the 2008 Financial Crisis – but from 2014 to 2016, bounteous oil supplies easily absorbed this demand growth. This was not the case in 2017 and nor will it be the case over the next 12 months, which provides the backdrop for our bullish outlook in 2018. Making exact predictions for the oil price is always a perilous game, but with today's price at $70 per barrel, we conclude that a price of $85 is significantly more likely than a price of $55, come the end of this year.