Oil Market Report – June 2010

Oil prices steadied at the beginning of June with a floor seeming to be found at $70 per barrel for crude oil. The last week of the month however, saw significant drops in price and this has left considerable uncertainty in the markets as to where prices will head in July.

Such uncertainty is nothing compared to the roller-coaster ride that is foreign exchange (international currencies), which dominated June more than oil prices. At times, the euro looked almost out for the count, which should make this summer's European holidays a little easier on the wallet. US holidays on the other hand, will remain expensive, as the US dollar continues to strengthen.

The question is often asked as to why the value of the dollar is so important with regard oil prices and the truth is, oil price movements can never be fully appreciated until the impact of the dollar is understood. To illustrate the point, 2 years ago British tourists were buying up consumer goods in the States because the £ was worth so much, ie, a $100 i-pod was worth £65 in 2007, but only £50 a year later as the exchange rate reached $2 for every £1. The same is true for purchases of oil. When the $ is weak, oil can be bought in local currency for relatively low prices. Looking at it in a different way, when the $ is weak, your £1,000 / €1,000 / 1,000 Yen goes a lot further and buys you a lot more oil.

Such a situation encourages both speculative and long-term purchasers of oil, particularly those from strategic reserve agencies or operators who are less exposed to price volatility (eg, State Oil Companies) to buy more oil and push prices up. Conversely when the dollar is strong (as it is at the moment), suddenly oil becomes less of a bargain and buyers disappear off the scene.

The graph attached starkly demonstrates this correlation. The red line shows the bulk gasoil price (the key marker grade for refined products) and it clearly rises as the blue line (international $ valuation) falls and vice-versa. So if we look at the situation in September 2008 and the start of the credit crunch, investors rapidly sought refuge in the US dollar, pushing its value upwards and gasoil prices fell rapidly. Then by January 2009, the oil market bottoms out and prices begin to rise and this is matched by a corresponding fall in the dollar.

Where next? A double-dip recession would continue to push the $ up in value (investors again seeking refuge in the $) and with that, gasoil prices would almost certainly fall. On the other hand, if the western economies slowly grow their way out of recession, then the $ will likely fall and gasoil prices rise. Portland's prediction is that the dollar will continue to rise in the short-term as fears remain around the bouncebackability (sic Iain Dowie) of western economies. However, by the end of the year, we see stronger growth, a falling $ and rising oil prices.

Perhaps it is best to delay that Florida trip until 2011...