Oil Market Report: January 2020

A new year (in a new decade!) and so time for some oily predictions from Portland Towers. Last January when we wrote our start of year report, oil prices were at $50 per barrel and we predicted that prices in 2019 would increase to a range of $65 - $75 per barrel. For much of the year, prices did indeed sit in our predicted range, although the average price for the 12 months was slightly lower at $64.23. Prices peaked at $75 per barrel in May, before steadying and then falling in the second half of the year, so that by December, the oil price stood at $67 per barrel. 98 working days in 2019 (40%) saw a price between $65 to $75, whilst 178 working days (70%) experienced prices somewhere between $60 - $70. So if anything we were a tad bullish in our range prediction (to the tune of around $5 / barrel), but as predictions go, we think we didn't do too badly...

2019's stand out factor was just how little the increasing tensions in the Middle East, affected the oil price. In any given year, missile attacks on Saudi oil facilities, the seizure of oil tankers in the Straits of Hormuz and targeted killings of Iranian officials by American forces, would have sent prices sky-rocketing. But in 2019, whilst these events did have immediate impacts (the Abqaiq-Khurais drone attack pushed prices up $5 a barrel overnight), price movements tended to be short-lived and oil prices soon settled back to "normal" levels. Primarily, this tells us that the oil market is in a bearish phase and Portland sees this trend continuing through 2020.

Our main reasoning is that most economists seem to agree that some form of economic slowdown is inevitable in 2020 and this will bring a slow-down of oil demand (a trend already evidenced in Q4 of 2019). It is also difficult to see how the current slight thawing of US-China trade relations will sufficiently lift the global economy, such that oil demand accelerates back to the growth levels of 2016-18. Meanwhile, on the production side, the US shale oil industry is pumping more and more oil (up 10% on 2018 volumes), making the US now easily the biggest oil producer in the world (a whopping 13m bpd versus 10m bpd each for Saudi Arabia and Russia). With export facilities in the Gulf of Mexico finally coming into play, this excess oil is now finding its way to global markets, just as demand looks to be tailing off. Put the two together and you have a recipe for drooping oil prices...

Such a scenario puts very significant pressure on our friends at OPEC, as they rein in their own production to try and drive prices back up. For the last 3 years, they have shown uncharacteristic discipline in maintaining agreed production cuts and in December, further production limits were also signed off. But it is now beginning to feel that OPEC is swimming against the tide, with more and more of their member states (and "guest" nation Russia) bitterly complaining about production caps, as they see shale oil simply gobbling up the market gaps that appear when OPEC pulls back. It is also worth pointing out that the constrained production regime introduced by OPEC at the end of 2016, was supposed to be a temporary 6 month measure (to "support the market"), but has now gone on for more than 3 years...

So we have a global economy possibly heading for skid row, the US shale oil industry going absolutely fracking crazy and the operational unity of OPEC beginning to crack – prices are only going one way surely? That would certainly seem to be the logical conclusion, but each one of the aforementioned bearish factors can easily be deconstructed. Number one; a concerted effort by Trump and Xi Jinping could easily set the global economy back into a mega growth phase. And remember, neither of these 2 Presidents play by any rules, other than their own. Two; the Saudis have just commenced the long-anticipated share flotation of their most precious asset (Saudi Aramco) and a prolonged drop in prices would be disastrous for that process. So expect them to do whatever it takes to maintain OPEC unity and continue to drive for production cuts. Finally, factor number three; it's not even a well-kept secret that most US shale oilers are not only massively in debt, but they haven't made any money for the last 3 years. A prolonged drop in prices will scatter investors and send them in search of considerably safer bets than shale oil. In turn, this would put most of the smaller, marginal producers out of business and the whole sector could easily implode, just as quickly as it "exploded" in the last decade.

Those are 3 entirely credible scenarios, which can be layered on top any number of potential bullish developments, such as the tension in the Middle East, regime change in Venezuela and the rapid decline of conventional (non-shale) oil exploration projects. Therefore, whilst a bearish year remains the most likely outcome for 2020 (with prices slowly ticking down), we will not be surprised to see some major price spikes over the next 12 months, as geopolitics and economics frequently boil over. Depending on when those spikes occur, the price of oil this time next year could easily be back up to the $80 mark - but for the average of the year, we expect a price of around $55 - $60 per barrel.

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