Oil Market Report: June 2021

Long summer evenings, shorts and flip-flops, pub gardens doing a roaring trade (hopefully) and holiday makers waiting to see which of this year's holidays will be cancelled (hopefully not!). It's the half-way point of the year, so let's look back at the last 6 months and see how the markets have fared.

Back in January, Portland predicted a strong rebound in oil prices after the lows of 2020. This arguably wasn't such a bold prediction, considering just how far prices had fallen - surely some form of recovery was inevitable? That being said, there was still enough demand uncertainty floating about at the time to keep many market observers on the bearish side, or at least maintaining a "flat price" point of view, which predicted little movement either way. As it was, prices did rebound strongly, with crude rising from $50 per barrel in January to $64 by the end of the first quarter. As we write this report, the June Brent price has tipped up further and now sits above $70 per barrel.

The obvious reason for this is increasing demand, with the western world coming out of lockdown and China...well...doing what China does, which is buy more and more oil whenever it can. However, the less obvious reason for the price rise – or at least the less documented reason – concerns oil supply and its failure to keep up with demand. In 2020, oil prices dropped so calamitously that multiple oil wells were simply "shut-in" (closed down) and numerous planned exploration projects have since been canned entirely. Contrary to the popular imagery of oil taps that can be quickly turned on and off, the reality of oil production is that once you stop the flow of oil, there is no effective way of quickly getting it back on stream. A shut-down well is either a permanent state of affairs or will take many months to get back to full production.

Oil producers and investors will of course be enjoying today's higher prices, but the likelihood is that few of them will see the current levels as anything other than a route to recoup some of 2020's losses. Even fewer will see this year's recovery as a clear enough signal to reinvest in oil production. Furthermore, whereas in the past, the industry has relied on the more agile shale industry to increase volumes and fill demand gaps, the post-2020 shale sector looks out for the count (no miracle Tyson Fury style recoveries here!). Debts are too big and shale operators increasingly find themselves in the legislative cross-hairs of the new Biden Administration. Add to this the final part of the supply jigsaw, which concerns future exploration and how and when these projects will be funded. Investors have been so scarred by the downward cycles of the recent past, that any large-scale oil projects will need to offer very significant returns (and quickly) if they want to get market backing. This is further pushing oil companies away from conventional oil exploration, as green energy projects have (for the moment) more patient investors, who are initially happy to take modest returns in the short-term.

With production limping and demand cantering, the more excitable in the analyst community are making ever more bullish predictions, forecasting that prices will soon be in excess of $85 per barrel. Some are even talking up a "super-cycle" of over-heating prices above the $100 mark. The latter certainly seems over the top, in so far that demand recovery is steady (rather than spectacular) and of course, further global lockdowns cannot be ruled out. But with the fundamentals of the oil market (supply vs demand) being so out of kilter, an increasingly strong oil price does look an odds-on bet.

One clear "wild-card" in the supply pack does remain though and that is Iran. Joe Biden is beginning to make favourable noises towards this "rogue" state and is keen to bring them back into the 2015 UN-EU sponsored nuclear deal. Should that happen, sanctions on Iranian oil exports could well be lifted by the final quarter of the year, thus allowing significantly more oil to access global markets. As OPEC's second biggest producer (after Saudi), Iran is certainly very keen to make up for the lost time of the Trump years. And unlike fellow OPEC members under production quotas (who thus cannot increase volumes), Iran can increase production with abandon - before it gets even close to hitting its own designated quota levels.

Extra Iranian volume would of course suppress prices, not to mention upsetting fellow OPEC member states who are only just beginning to see the light after last year's bloodbath (and also cannot bear the thought of allowing Iran to take market share). This in turn might well lead to changes in overall OPEC production policy, but along with sanctions being removed, any changes along these lines will not happen until the back-end of the year. Which means for the here and now, you can expect oil prices to provide extra heat this summer!