Oil Market Report: January 2022

Although sensible people try to avoid making oil price predictions, we like to put our head “above the parapet” at the beginning of each year, with a projection of where we see prices over the next 12 months. Before doing that, we’re happy to point out that in 2021 we got our price predictions pretty much bang on, meaning that for 9 out of the last 10 years (exception = 2014), we have got our annual forecasts broadly correct. We won’t labour the point as no-one likes a smart-a*se and the reality is that 2021 was a fairly easy year to call after the carnage of 2020. Prices were low, investment in new oil and gas projects was non-existent and the economic impact of covid (ie, lock-downs) looked likely to diminish as 2021 progressed. It didn’t take a genius therefore to conclude that prices would rise.

And so they did with the price of crude starting the year at $55 per barrel (Jan 21) and finishing at $77 (Dec 21), having hit a peak 2 months earlier at $86 per barrel in October. The narrative behind these price movements was pretty much as we wrote last year; “we predict that prices will go up in 2021 and even see the possibility of a major price spike, as the gap between supply and demand becomes critical”. As we turn our attentions to 2022, we can say that the supply-demand situation remains critical and in fact, the danger of a major price spike looks more likely this year than it did in 2021. Ongoing factors around declining investment in oil and gas, coupled with buoyant demand growth are still at play, but a joker has now been added to the pack and that is the extraordinary situation regarding global gas prices.

We covered this in detail here; https://stabilityfromvolatility.co.uk/market-reports/energy-market-report-10-21/, but when the price of any commodity octuples (natural gas has risen by over 800%!!), buyers naturally start to look for alternative sources of supply. Crude (or refined crude) is one of those alternatives and power stations, heavy industry, fertiliser manufacturers and a legion of other gas users are all now switching to oil. Anecdotally, only last week Portland was approached by a food processor who wanted to switch to oil because the gas price made their operations commercially unviable. And whilst the general public may consider oil prices already to be too high, they are still nothing like as high as gas! The collateral damage from the high gas price can be seen everywhere and oil isn’t the only commodity being leaned on as a result. Coal too has seen an incredible recovery over the last 12 months, with demand rising by over 10% and global coal powered electricity in 2021 hitting all-time record highs. Even more concerning is the International Energy Agency’s prediction that these figures will be exceeded in 2022.

The current situation should also be a surefire opportunity for renewables to fill the gap created by exorbitant gas prices. To a certain extent this is true in Europe and North America, where renewables are well developed and already plugged into the energy grid. However, where there are the greatest energy requirements (China, India, South-East Asia), green energy simply cannot keep up with the rapid growth in electricity demand that comes with post-pandemic economic recovery. This is a subject that Portland has returned to many times and is the reason why gas exploration (if not oil) must continue, because the alternative is a world where coal usage rockets every time gas prices become too high. Only a regular supply of new gas over the next 10 years will stop these price spikes taking place.

Let’s go back to oil though and where all of this leaves the price in 2022. The likely development is that oil prices will significantly increase in the first 6 months of this year, with supply continuing to be starved, whilst rebounding economies and hitherto users of gas, put significant pressure on oil demand. Hopefully the gas crisis will have dissipated somewhat by Q3, as the American fracking industry responds to clamouring demand. This in turn should bring more crude to the market, as fracked gas goes hand in hand with fracked oil. Prices then should ease by Q4, although they will still end the year higher than they are today.

In numerical terms, we easily see oil topping $100 per barrel in the next 6 months, before settling at the $80 to $90 per barrel band by December. Only one thing can realistically stop this happening and that of course is Covid. You only have to see the impact of the Omicron strain in December (21) to see the profound impact covid continues to have on oil markets. In the run-up to Christmas, oil prices fell by an incredible $10 per barrel, as traders and analysts panicked about the possibility of further covid related lockdowns. So in 2022, any new strain of the virus, a growing inefficacy of the vaccines available or a sudden increase in hospital patients (at a national level) could all bring about new lockdowns and (if the last 2 years is anything to go by), that would bring oil prices crashing down. All of which rather leaves us between a rock and a hard place when it comes to what we wish for in 2022. Most of us would welcome an end to lock-downs, but we then have to accept that this will bring inevitable and unwelcome increases in the price of oil.