Oil Market Report: January 2021

A new report for a new year, although let's face it, 2021 has hardly started off in a way that any of us would have wanted! Nonetheless, we soldier on, and this month we will look back over the last 12 months and then make some bold predictions for the year ahead. This time last year, it's fair to say that nobody had a handle on just how bad things were going to get in 2020. Nonetheless, when it came to oil prices, Portland was predicting a drop. We stated back in Jan 20 that the "oil market was in a bearish phase" and that "excess US oil production, alongside reduced global demand were recipes for drooping (sic) prices in 2020".

This means we got the basics right, but as any oil trader will tell you, predicting the general direction of travel (up or down) is the easy bit. To make money, you need to predict the scale and speed of movement. Here - alongside every other oil analyst, investor and operator – we were way off! Even at February's 2020 London "Oil Week", and despite several high-profile (and last-minute) cancellations, the virus was still not seen as a long-term threat. Nor did anybody at the time predict that a supply war between Russia and Saudi Arabia would swamp the market with oil, just as demand was falling off a cliff because of the pandemic. The resulting glut of oil led to one of the most bizarre market occurrences ever, when on April 23rd, the price of oil dropped to minus $37 per barrel. We're fairly sure no-one predicted that one either!

The tenure of this extra-ordinary "negative pricing" period was very short-lived (1 day only) and the circumstances as technical (pipeline constraints, expiring futures contracts) as they were market driven. Furthermore, apart from a handful of Chinese Hedge Funds (one of which was wiped out entirely), there is scant evidence that the events of April 23rd 2020 caused sustained commercial damage to either operators or (non-speculative) industry investors. Nonetheless, the significance of negative oil prices should not be under-estimated. Conventional and long-held wisdom is that commodities always have a residual value – that is what makes them attractive for investment. So even below $10 per barrel, there is still a market for oil somewhere and with efficient processes and the right supply-chain, there is money to be made. But a minus oil price (alongside negative interest rates) is a different story entirely and although few will publicly admit it, the precedent now set by negative oil prices has spooked investors and oil company shareholders alike. Of course, one crazy day is not necessarily a window on the future, but it may have been an insight into a new low-carbon world, where oil producers are desperate to keep volume coming out of the ground, at the same time that demand steadily declines in the face of renewable fuels.

The jury is probably still out on that one, but what we can say is that the price race to the bottom was devastating for the petrostates, the US shale industry and the major oil companies. The chaos surrounding OPEC's decision making throughout 2020 highlights how misaligned member states are and also just how much pressure they are under. OPEC countries typically require oil prices to stay above $75 per barrel to balance the books, and a price that is consistently at that level feels some way off at the moment. Not to mention the fact that OPEC's ongoing oil growth assumptions look increasingly out of kilter with a decarbonised world. US shale is facing its own day of reckoning with the number of oil rigs already having halved in 2020 and the spectre of $20bn of debt that will mature in 2021. This will either have to be repaid (no chance) or re-financed (somehow). As for the oil majors, they have either faced the ignominy of sliding out of the public eye (ExxonMobil were ejected from the Dow Jones Industrial Average, having been a member since 1928) or are desperately trying to convince wary investors of their green credentials and plans for a renewable future (like BP). One thing is for sure, none of them are heralding new or existing oil exploration projects.

But here's the thing, whilst there is largely agreement (outside of OPEC at least) that global oil demand will decline much sooner than previously predicted, immediate demand is beginning to recover – particularly in China and South-East Asia. As that demand is gradually ticking back up (from pandemic lows), supply continues to collapse. Investment in oil exploration and production is down by 30% globally and by 40% in the West. Moreover, there is no operational mechanism that can switch global supply back-on quickly and nor is there much financial appetite for re-investment in old school oil projects.

Which is why 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. That isn't to say that we see a long-term recovery for oil prices, but we do easily see another year of significant price volatility, but this time in an upwards direction. If we assume modest economic growth over the next 12 months, then there is currently inadequate supplies of oil to meet the demands of a recovery. It also has to be recognised that renewables are still some years away from being able to fill the gap and meet demand. Such a scenario could easily be a recipe for significant and sudden price increases. That being said, if 2020 taught us anything, it is that Covid-19 will have the final say and could easily blow our predictions way off course. Sorry to say that whilst we may all be tired of covid, covid may not yet be tired of us...