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Have Oil Prices Bottomed Out?

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This post is an English translation of an article written by Jorge Nascimento Rodrigues and published in the 28th of February in the Economy section of the Journal Expresso, the largest weekly publication in Portugal. It is built on the insight kindly provided by TheOilDrum contributor ace.

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Crude Oil
February closes with a per barrel price close to $45

Crude oil prices might be back to a mid term bull market, says an Australian analyst. February showed significant price variations from one day to the other and the American variety [WTI] climbed 10%, increasing from $40.78 to $44.76 per barrel.

An audio version of this post can be downloaded here.

Minimum prices for a barrel of crude oil, since the peak in July of 2008, may have happened before Christmas of 2008, according Anthony Eriksen, an analyst for TheOilDrum. Eriksen is a Canadian mathematician located in Sydney, Australia, where he specializes in energy and mining investments.

The conclusion that can be made is that the price of a barrel might be back to a mid term bull trend, after a fall from $145 to less than $50 in the span of only six months last year.

Eriksen points out that prices of the American crude (WTI) and of the European (Brent) touched their minimum values of $31.41 per barrel in December 22, 2008, and $34.04 on Christmas Eve, respectively. This year, the lowest prices occurred last week, on the 18th of February, with values of $34.62 for the WTI and $39.10 for Brent.

The International Energy Agency (IEA) forecasts a price range between $40-$45 per barrel, which would still be below the wishes of many producing countries. These countries require a minimum of $50 barrel for many of their planned projects to be viable, both economically and technologically, emphasizes the analyst.

On February 26th, the price of a barrel of the American WTI variety reached a price slightly above $45 and closed at $44.76 dollars. The Brent variety closed the month at a price ($44.72) practically identical to the opening figure ($44.46).

Daily Brent Blend prices since last September. Source: [UpstreamOnline.com](); image not in original article.

Wild Oscillations

Nevertheless, the fundamental behaviour of prices this year has been what some analysts ironically dub “wild oscillations”.

The months of January and February have been filled with that kind of very close extreme variations; at least 11 cases were observed for the WTI variety in February alone: on February 10, declined 5% and climbed 10% on February 13; on February 17 declined 7% and climbed 14% on February 19; on February 23, declined 3.6% and climbed 4.2% on February 24; 6.6% on February 25 and 8.5% on February 26, then down again on the last trading day of the month. This reveals the high volatility of WTI's behaviour in this market.

What will be the outcome of these extreme oscillations and whether the barrel price will again climb above $50 or fall below $30, depends, according to Eriksen, on the “balance” between two opposing forces.

On one hand, the impact of the crisis on the demand for this commodity, continuing to reduce demand below 85 million barrels daily (mbd) – the last estimate by the IEA points to 84.8 mbd. This daily figure was still **below** the supply in January of 2009, that was around 85.2 mbd, resulting in a difference of 400 thousand barrels daily.

On the other hand, there are several political and physical factors that can be expected to influence supply, producing scarcity in the market. Nothing has happened yet, in spite of the cuts planned by OPEC, that “should already amount to 89% of the commulative cuts announced since September that amount to 4.2 mbd, according to Bloomberg”, says Eriksen.

Black Swans

The analyst emphasizes that, in the political arena, sudden geopolitical changes in oil-producing regions (namely in the Middle East that continues to be potentially flammable with issues like Israel/Palestine and Iran) or a collapse of the dollar due to the continuing financial crisis or to the political behaviour of the main American currency supporters, can make the crude oil price shoot up without previous warning. It would be the surging of separate “black swans” to the international scene.

Physical constraints can also have a negative influence on supply. Eriksen indicates that the group of oil producing countries outside OPEC seem to have already reached a production peak, on a combined basis.

In spite of good prospects in places like Brazil (that, nonetheless, can be expected to reach “a production plateau around 2011”, according to the studies of this analyst) and Canada for a few more years, global supply outside OPEC is diminishing, with high decline rates of around 20% in extreme cases like the Gulf of Mexico. In 2009, production can be expected to decline in Russia, Mexico, Norway and the United Kingdom.

With respect to OPEC, a continuation of the policy of planned cuts is to be expected, with a reevaluation coming as soon as the 15th of March, when the cartel meets again. A pressure group formed by Algeria, Iran, Iraq and Venezuela is supportive of the policy of continued cuts, according to statements issued during the last week and a half.

ace adds this final comment:

There remains great uncertainty about key OPEC producer Saudi Arabia's true oil reserves as they are kept as a national secret. The last time that Saudi had a production peak was in 2005 at 9.6 mbd. There is a risk that Saudi Arabia's true crude oil reserves could be much smaller than official estimates implying that future production will stay below the 2005 peak.