Energy and Commodities / Global Economy

The outlook for oil prices

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It has become common to see spikes in oil prices. Since October the price of Brent crude has fallen by 30% to around US$59 per barrel, its lowest level since October last year. This fall contrasts with the rise that the market was expecting in the third quarter. Now however, oil prices seem to be heading towards levels which, while benefiting consumers, make achieving developed countries' inflation targets seem ever more distant and jeopardise the stability of oil-producing regions and companies around the world.

One of the reasons behind this shift in trend is the unexpected change made by the Trump administration to the way the sanctions against Iran are applied. With exemptions allowing eight countries to continue to import Iranian oil - including the two biggest buyers, China and India - the likelihood of the sanctions leading to a chronic balance of payments deficit has diminished significantly. The measure surprised countries that had already positioned themselves for what they believed would be a strict application of the sanctions. This is added to the effect of increased production by OPEC members, mainly concentrated in Saudi Arabia and Iraq, as well as by non-OPEC members, particularly Russia and the United States.

Apart from this, things are not looking good on the demand side. World economic growth is showing signs of slowing. Trade tensions between China and the United States have increased. The strength of the dollar has made oil more expensive for importing countries, particularly those whose currencies have seen significant depreciation, such as Turkey and India.

At its next plenary meeting, OPEC, in coordination with Russia and other partners, is very likely to cut supply by between 1 and 1.5 million barrels a day and so rein in the fall in prices. Nonetheless, in view of the prospect of continually increasing US production and less dynamic demand, the likelihood of a new price escalation is significantly reduced. To all this we should add the ever more explicit pressure that president Trump has brought to bear on OPEC to hold prices "low." However, what the president sees as a sort of "tax cut" for households, is at the same time a burden for producers in Texas and other parts of the country.

For the foregoing reasons, a scenario in which prices fluctuate between 60 and 70 dollars a barrel seems to us more viable in the short and medium term, without ruling out a downward bias.

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