FAR Limited

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The Oil Patch

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The recovery in oil prices to three-year highs came to an abrupt halt in early February, with benchmark prices giving back all their 2018 gains but nevertheless remaining well ahead of the mid-2017 lows.

WTI retreated from $US63.73/bbl in mid-January to $US60.77/bbl in mid-February, while Brent gave up its "seven handle" by falling from $US70.26/bbl to $US64.42/bbl in the same period.

Current prices don't look too bad compared with last June's miserable $US43/bbl (WTI).

What's more, having cut costs to cope with $US50/bbl prices, optimism in the oil patch remained at its best levels in years. That has been reflected in oil majors increasing dividend payments in the expectation of oil settling in to a $US60-$US70/bbl trading range for the foreseeable future.

The near 10% price fall in the space of a couple of days early in February nevertheless signalled a step-up in price volatility in line with other markets, most notably equity and debt markets.

While oil's early February price slump coincided with the shakedown in global equity markets, it was the release of a bunch of negative forecasts and data sets that made $US70/bbl oil a bridge too far for the time being.

The February oil market report from the Paris-based International Energy Agency did not help oil's cause. It said fast rising production in non-OPEC countries, led by the US, is likely to grow by more than demand.

"For now, the upward momentum that drove the price of Brent crude oil to $US70/bbl has stalled; partly due to investors taking profits, but also as part of the corrections we have seen recently in many markets," the IEA said.

"Most importantly, the underlying oil market fundamentals in the early part of 2018 look less supportive for prices."

The IEA nevertheless commented that it was clear that strong demand growth in 2017, alongside a modest increase last year in non-OPEC output and cuts made by OPEC, had contributed to the "extraordinarily rapid fall in OECD oil stocks."

"A year ago, they were 264 million barrels above the five-year average and now they are only 52 mb in excess of it," the IEA said.

The sharp fall in stocks was despite higher oil prices underpinning a new growth spurt for US shale oil production which has climbed to more than 10m barrels-a-day, over-taking Saudi Arabia, and putting the US on track to take over from Russia as the biggest oil producer.

Still, oil prices recovered some of their lost ground on February 14 by posting their biggest gain of the year in response to data showing US stockpiles had risen by less than expected – highlighting that heightened price volatility is the order of the day.

And while the IEA cast doubt on the oil market rebalancing, Saudi Energy Minister Khalid-al-Falih said in mid-February that OPEC would rather leave the oil market short of supplies than start winding-back production cuts started in January 2017 under an agreement which continues to the end of this year.

His comments were taken to mean that OPEC wants oil prices to stay above $US60/bbl.

So is $US70/bbl-plus realistic?

Morgan Stanley thinks so, with the investment bank maintaining a $US75/bbl price target for the September quarter.

"To get back to an oversupplied market, supply growth would need to exceed 2.0 mb/d this year. With OPEC contributing very little to this, we do not see non-OPEC growing fast enough to close the gap. This will leave inventories on a downward trajectory, and keep futures curve in backwardation. Unless other markets continue to sell off sharply, we still expect that attractive roll yields will ultimately attract sufficient inflows to drive prices higher, especially after the recent setback."

Aussie oil patch warms up:

Reflecting the renewed optimism around a $US60/bbl-$US70/bbl trading range for oil, notwithstanding the early February volatility, the Aussie sector continues to bubble.

Beach Energy has wrapped up its $1.59 billion acquisition of Origin energy's conventional oil and gas business, known as Lattice Energy, and Woodside is raising $2.5bn to expand its LNG interests, as well provide funding support for the SNE Phase 1 oil development in Senegal (the subject of arbitration proceedings on FAR's right to pre-empt ConocoPhillips' sale of a 35% stake to Woodside).

And finally, the shoot-out for control of AWE looks to be over after Japan's Mitsui & Co knocked out the competition with a $602m takeover bid.

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