Could the Price of Oil Reach US$200 in 5 Years?

Description

These days, there are plenty of predictions for the future price of oil. But one forecast stands out in particular.

In an article originally published in *The Telegraph*, Claudio Descalzi, chief executive of Italian oil giant ENI, said that “Prices could jump to $150 or even $200 over the next four or five years.”

Is there any validity to his claim? Below we take a look.

A drop in investment

Mr. Descalzi makes a very simple, and convincing, case. Because oil prices are so low, companies are slashing investment budgets. And eventually, that will cause supply to go way down. Furthermore, large-scale oil projects typically take years to bring online. So when demand rebounds, it could take supply quite some time to catch up. If producers hesitate to turn the taps back on — perhaps because the oil price slump is still fresh in their minds — then oil prices may be driven even higher.

We’ve seen this happen before. Back in the late 1990s, oil prices fell to roughly US$10 per barrel. In response, Saudi Arabia and other oil producers cut supply dramatically. These countries also held back on investment spending. Then over the next decade, China’s growth led to a surge in oil demand. Supply was not able to keep up, and oil prices climbed as high as US$147 per barrel in 2008.

So can history repeat itself?

I wouldn’t be so sure. There are some big differences between 2015 and 1999.

First of all, China’s growth was unlike anything we had seen before. The world’s most populous country was growing at double-digit rates every year. And this caught everyone off-guard. No wonder oil supply was unable to keep up with demand! But such a shock is unlikely to happen again anytime soon.

Second, the industry is reacting very differently than it did in the late 1990s. Back then, there was a legitimate fear of $5 oil. That's why OPEC cut production.

But this time, the industry seems to be bracing for a rebound. As a result, producers aren't really cutting production at all. Instead, they're putting longer-term projects on hold, and simply "riding out the storm" in the meantime. As soon as oil prices rebound, these larger projects can be restarted.

Some big projects aren't even being deferred. Below we look at a prime example.

Fort Hills

Fort Hills is a 50-year, $13 billion oil sands megaproject led by **Suncor Energy Inc.** Other investors include France's **Total S.A.** and **Teck Resources Ltd.** (TSX:TCK.B)(NYSE:TCK). The economics of Fort Hills are very marginal — one analyst recently estimated the breakeven oil price of Fort Hills at US$96 per barrel.

But Suncor is pressing ahead anyways. As CFO Alister Cowan said, "You don't make decisions on 50-year life on the basis of spot price, so we would expect to see multiple periods of price volatility during the life." Teck CEO Don Lindsay is also enthusiastic about the project. He says that low oil prices will make Fort Hills cheaper to build.

Both Mr. Cowan and Mr. Lindsay make good points. But anyone who thinks this is 1999 all over again is in for a rude awakening.

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Date
2025/07/22
Date Created
2015/01/27
Author
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