The Oil Price Plunge: Is This a Repeat of 1998 or 1986?

Description

If you ask any veteran of the oil industry about the current oil price plunge, you're likely to hear a very familiar phrase: "We've seen this before."

This is a good point — oil prices crashed by more than 75% from peak to trough during the financial crisis. Looking further back, oil prices plunged from US$25 per barrel in early 1997 to below US$10 in 1998. Each time, oil came roaring back. So will history repeat itself this time?

Before answering this question, one has to look even further back. From November 1985 to April 1986, oil prices plummeted by nearly 70%. But that time, the price remained depressed for years, only spiking back up when Iraq invaded Kuwait in the early 1990s.

So it's pretty safe to say that history will repeat itself. But will it be a repeat of 1998 and 2008? Or will it be a repeat of 1986? And as an investor, what should you do? Below we take a look.

2008 and 1998

The oil crash in 2008 was fairly unique, having been caused by the worst economic crisis of our lifetimes. It would be a mistake to compare that crash — which was caused by a lack of demand — to this one. It's more worthwhile to focus on 1998.

At that time, production from OPEC countries was booming, and the Asian financial crisis was depressing demand. As mentioned, oil prices plunged below $10. Interestingly, at this time, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) was planning Project Millenium, a $3.4 billion expansion to its oil sands operations. As the company argued, you want to be building during a down market, when input costs are lower.

Suncor's moves turned out to be brilliant. OPEC cut production, the Chinese economy went on a spectacular run, and oil prices took off. No wonder the company today is pushing ahead with its Fort Hills megaproject. If oil prices recover in a similar way, as Suncor expects, then the company will again be vindicated.

But hold on: What about 1986?

The oil price crash in 1986 has a lot in common with today’s events. At that time, Saudi Arabia got tired of increased production in other geographies and decided to boost output to regain market share. What followed was a war of attrition. And guess who lost? Higher-cost producers in the United States. Early construction of Alberta’s oil sands was also brought to a halt.

Oil prices did spike up during the first Iraq war, but then fell right back and stagnated for most of the 1990s. Only in 1998, when OPEC cut production — and China went on an incredible run — did oil prices finally take off.

So what should an investor do?

Let me ask you this: Is Saudi Arabia about to cut production? Is China (or any other country) about to take off? Personally, I have my doubts.

For these reasons, the current crisis looks a lot more like 1986 than 1998. So if history repeats itself, then Suncor is likely making a big mistake. And as an investor, you should stay away.

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