

Oil price volatility: how can it be managed?

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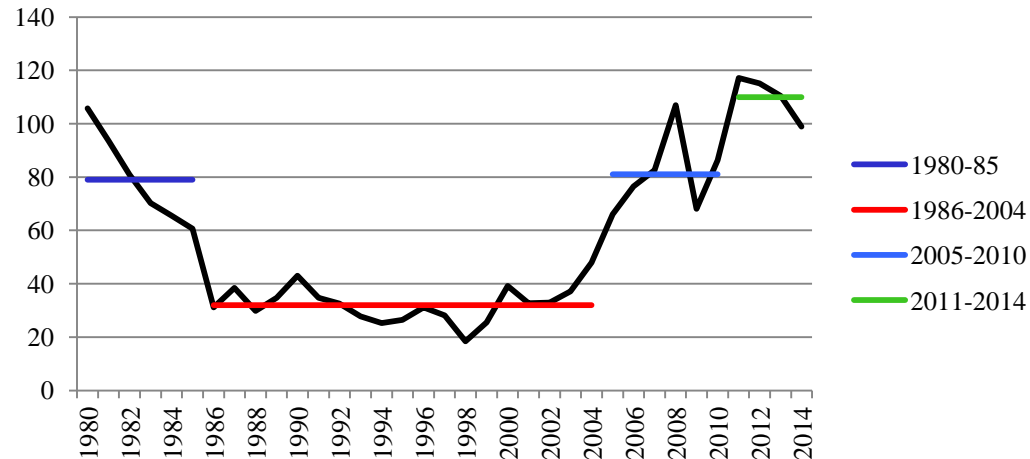
Presentation outline

- The recent history of price volatility?
- Drivers of price volatility?
- Prospects for future price volatility?
- Why does price volatility matter?
- Possible solutions to price volatility?

Recent history of price volatility

- **Previously** an administered market
 - 1928 Achnacarry Agreement + Gulf Plus
 - Posted prices 1950s/60s
 - OPEC price setting post October 1973
- **Now** a competitive market
 - Saudi Arabia and market share. November 2014
 - Absent an administered market, greater price volatility?

Crude oil prices 1980-2014 (Brent 2014 \$US)



Monthly WTI price 2000-April 2016



Drivers of price volatility?

The problem is there are two oil markets

Wet barrel market

*Trading real barrels

PRICE DETERMINED BY PHYSICAL
SUPPLY AND DEMAND
Economics 101



Paper barrel markets

*NYMEX/ICE – futures markets

PRICE DETERMINED BY PAPER
PROMISES ABOUT SUPPLY AND
DEMAND
Psychology 101



The two oil markets – the linkages?

Wet barrel market

Paper barrel markets

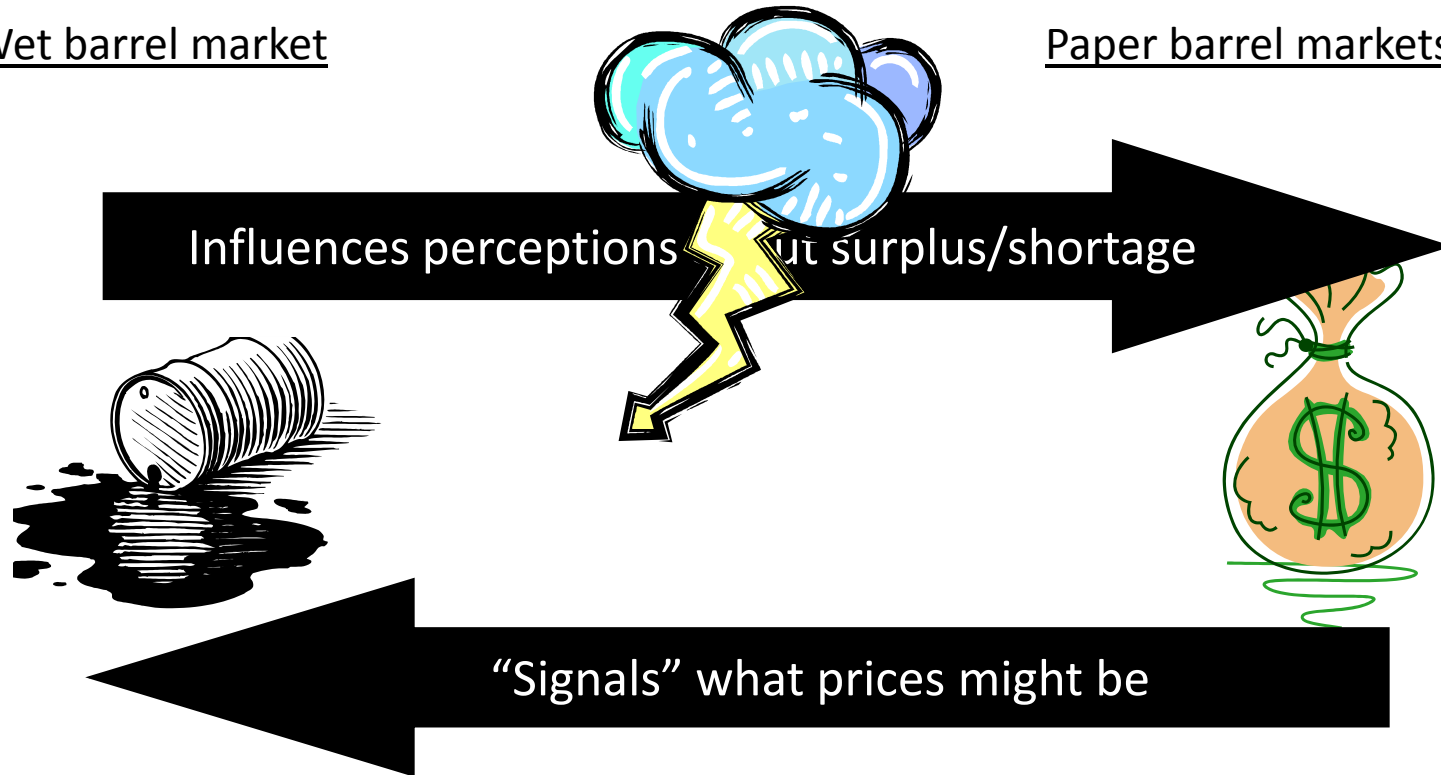


**Key point is that perceptions and signals can change very quickly:
ITS ALL IN THE MIND!**

The two oil markets – a further problem

Wet barrel market

Paper barrel markets

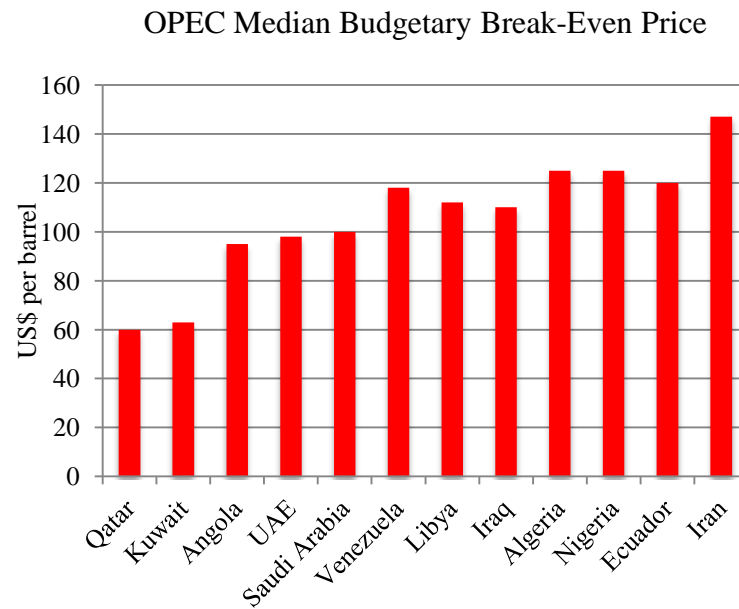


“the paper barrel market” often misread the “wet barrel market”. They don’t understand the oil industry...

“Scapegoat theory” in foreign exchange markets

Prospects for future price volatility? Short term

- Price range in a competitive market?
 - Floor price = variable cost of US tight oil? \$20-25?
 - Ceiling price = what breaks the “fracklog”? \$50-55?
- Supply disruptions?
 - “Accidents” (Canadian fires)
 - Geo-political problems
 - Unrest in producers (Venezuela)
 - Growing Iranian frustration with the JCPOA
 - The Middle East is a mess!

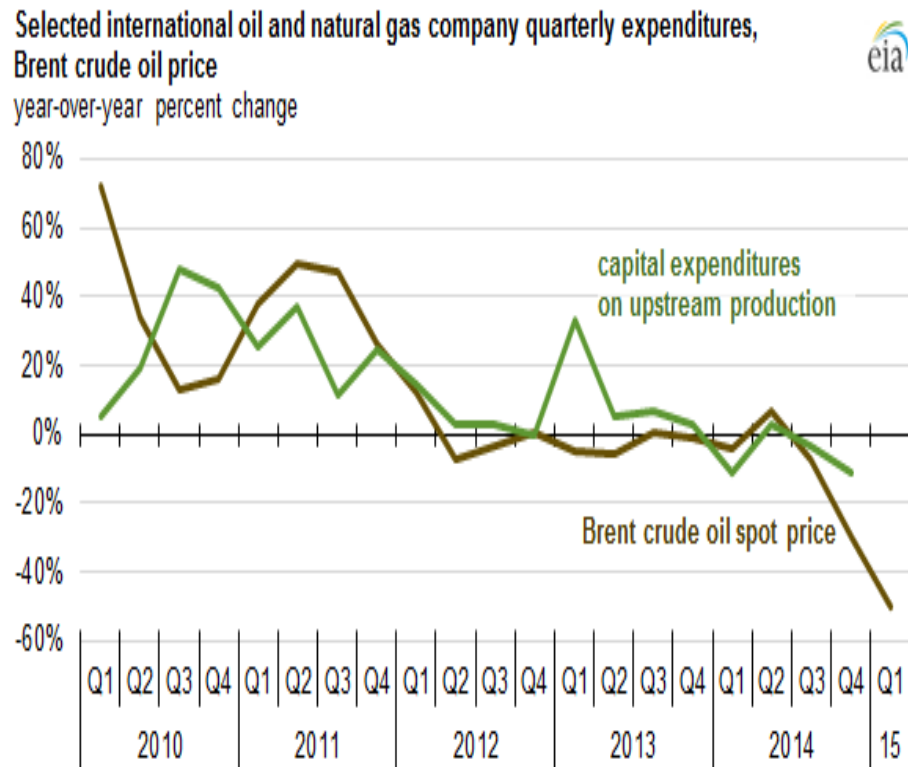


Source: Ali Aissaoui Apicorp Economic Commentary
Vol 9 NO. 708 July- August 2014

Prospects for future price volatility? Medium term

- **A supply crunch?**
 - Increasing demand and lower investment in conventional upstream?

- **Changing price elasticity of supply**
 - Shale technology revolution and lead times

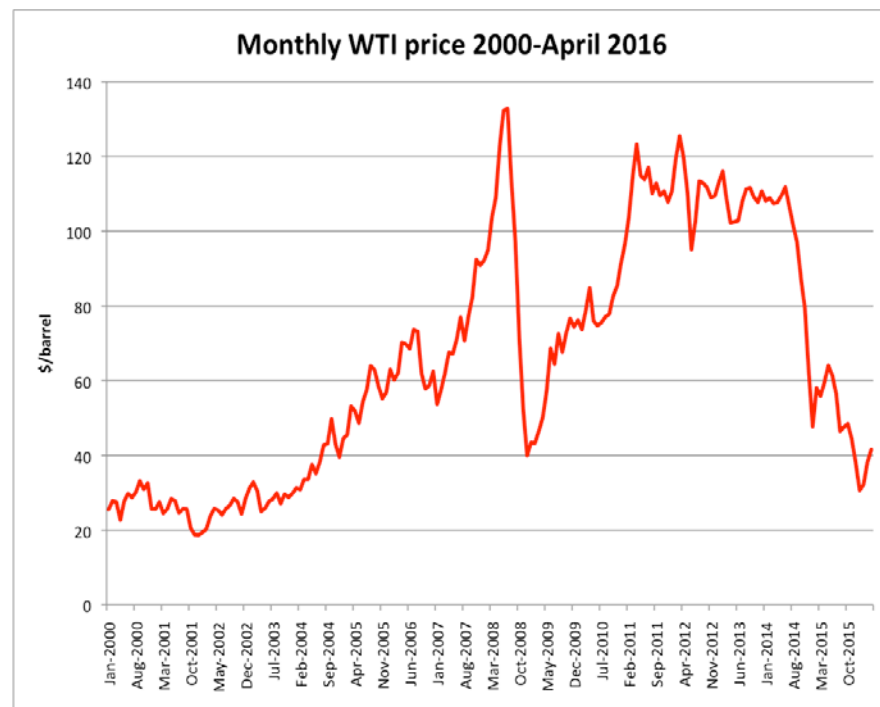


Prospects for future price volatility? Long term

- **Remember: long term = the sum of a series of short terms**
- **Longer term the issue is price trends rather than price volatility**

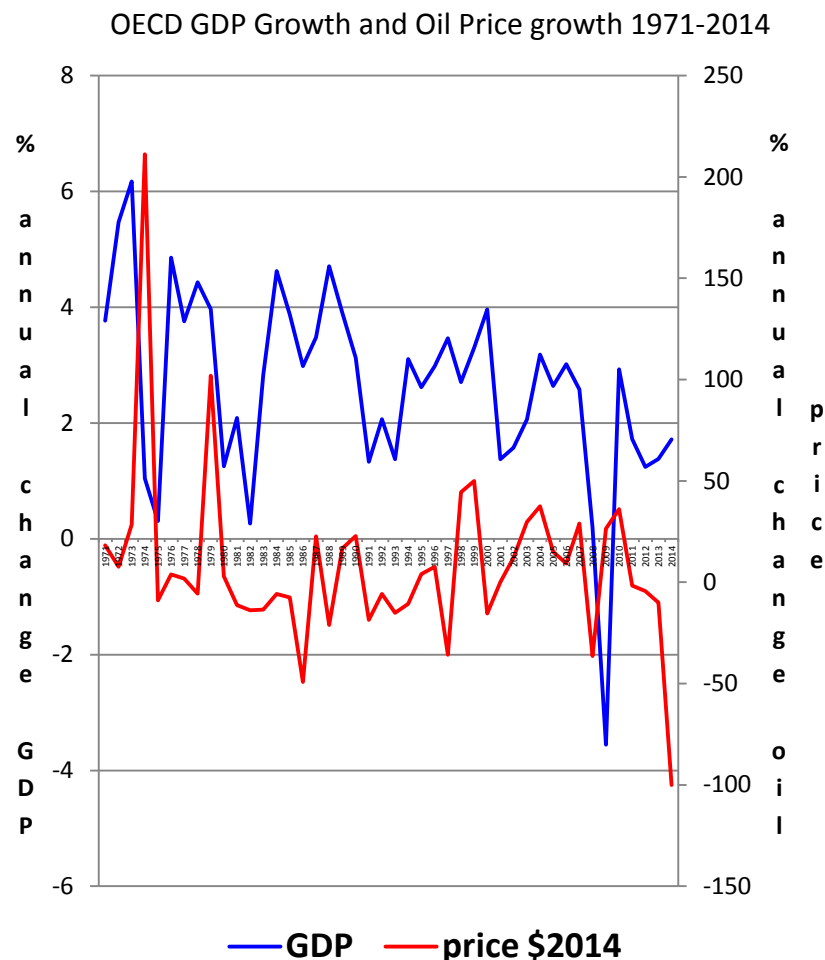
Prospects for future price volatility? Conclusions

- While oil prices are determined in a competitive market, volatility is likely to get worse



Why does price volatility matter?

- **Global**
 - Impact on global GDP
 - Impact on energy investments
- **Producers**
 - Macro consequences – budgets and balance of payments
- **Consumers**
 - Balance of payments
 - Domestic energy policy



Possible solutions to price volatility?

- Revert to an administered price?
 - Prospects for agreements? – OPEC/Non-OPEC?
Revive OPEC quotas?
- Physical stock piling?
- Hedging and the use of paper markets?
- Manage it by creating “stabilization funds”?
- Live with it!



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THANK YOU FOR YOUR ATTENTION

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