Do Oil Price Patterns Repeat Themselves over Time?

Remembering that it wasn't Long Ago that $70 per Barrel Seem Ridiculously High; One Pundit Correctly Predicted the Collapse Based on History, but How Long will it Last this Time?

SCDigest Editorial Staff

Among the most vexing issues for today's transportation managers is certainly the price for oil and hence fuel costs.

Whether it's fuel surcharges from carriers, fuel costs for private/dedicated fleets, or other expense buckets, rising oil prices play havoc on transportation costs. Of late, the issue is also the dynamic nature of oil/fuel costs, requiring shippers to change strategies rapidly depending on fuel cost dynamics of the moment to minimize total freight expense.

Given all that, it's worth looking back at a couple of data points.

First, in the past week oil has moved back over the $50.00 per barrel level. Where does it go from here? While some market experts say the fundamental supply-demand balance and current inventory levels suggest oil should be more like $30.00 per barrel, others say that the falling value of the dollar and potential high levels of inflation resulting from economic stimulus plans will keep pushing oil costs higher.

That's because for now, oil is priced internationally in US dollars, meaning that as the relative value of the dollar falls versus other currencies, the price that oil producing countries charge should go up in response.

Many observers, in fact, say the falling value of the dollar in 2007-08 was a key factor in the rapid rise of oil prices in that period.

Relatedly, some are saying the recent rise in oil prices back over $50.00 is a result of speculators driving the price upward in futures trading that is not well connected to overall supply and demand – the same scenario led to the dramatically higher prices in 2007-08, according to many market observers.

As legendary oil industry investor T. Boone Pickens recently predicted, "We'll see $70 dollar oil before we see under $40 dollars again." That sounds about right.

Second, it's interesting to remember that it wasn't until 2005 that concern started to set in about oil costs when they crossed just $50.00 per barrel. In mid-2007, the price per barrel was still under $70.00, but deep concern existed at that time about the impact on supply chain costs even at those levels. Then, in the second half of 2007 and through the first half of 2008 oil prices dramatically ratcheted up another leg, ultimately reaching a peak just short of $150.00 per gallon in July of 2008.

That then was followed by the dramatic plunge to just above $30 at one point earlier this year, accelerated by the global financial crisis and resulting drop in demand and a strengthening of the dollar. Now, however, current levels are about 60% above those market lows.

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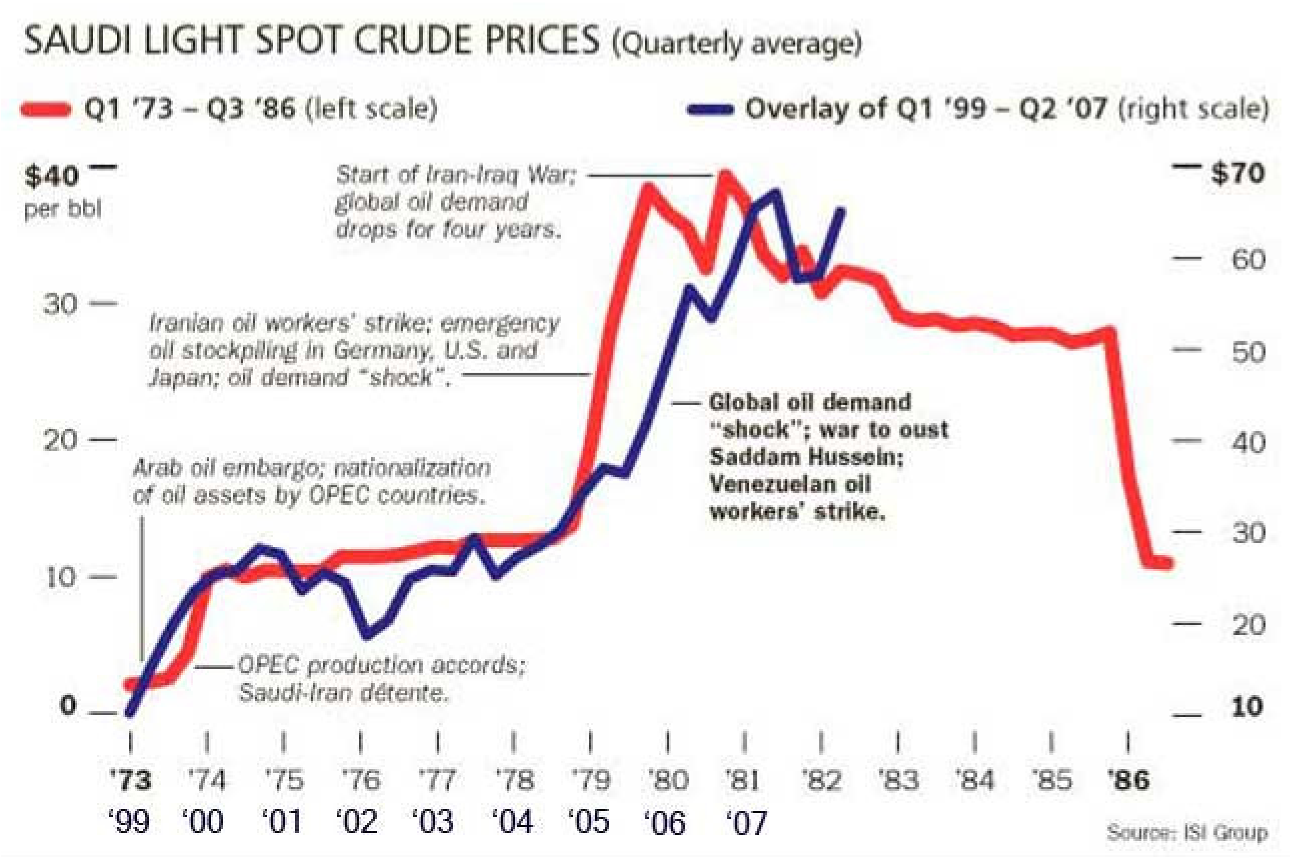

One Expert Called the Plunge in 2007

Interestingly, one market pundit predicted the eventual plunge in oil prices as far back as 2007. We reported back then that even as companies were panicking as oil prices neared $70.00 per gallon, **Mike Rothman**, an oil industry expert at research firm ISI Group, overlaid a period of similarly rising oil prices in the 1970s to the early 1980s. He used that chart to predict a sharp contraction in prices soon after the rise to $70.00, as we illustrate again below. (See also **Is Oil Price History about to Repeat Itself?**)

In retrospect, Rothman was a bit premature if ultimately correct about the collapse of oil prices. He predicted a collapse at prices not much more than $70.00 per barrel, whereas prices would accelerate for another year before their ultimate steep descent.

Looking back at the earlier period of rapid increases, the dramatic decrease in oil prices in the early 1980s was followed by a long period of very flat prices for almost 20 years. In fact, as late as 1999 the price for oil was only about $15.00 per barrel.

We suspect that pattern is very unlikely to be the case this time. For reasons ranging from overall mid-term trends in global demand for oil to the increasing level of geopolitical risks that can cause dramatic swings in oil prices today, SCDigest suspects the likely trend of the next few years is still higher, though probably not back to anything like the peaks of 2008 for a number of years.

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