The Complete Guide To Global Oil Market Trading

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SAMPLE

1. The Early Oil Price Wars

Trading Overview

At the heart of all major price trends in the oil market are significant changes in the balance of global supply and demand, and the longer disequilibrium persists, the longer the price trend will endure. Because the fundamental factor that drives the demand element of this equation – economic growth across the key economies of the globe – has fallen in recent years within a relatively narrow band, changes in demand over that period have tended to have a much less immediately dramatic effect on oil pricing than changes in supply.

The expansion of China's economy, for example – with average annual GDP growth of 9.91% from 1979 to 2010 and a peak of 15.2% in 1984 – underpinned a corollary rise in the demand for many commodities, including oil, creating a rising floor for prices that powered what became known as the 'commodities supercycle'. As that rate of economic growth has moderated in the last few years – dating broadly to the onset of the global financial crisis in 2007/08 – the China effect has been much less pronounced on oil pricing than the effects of the oil price wars periodically fought between key oil suppliers.

Each of the major oil price wars that have been fought between the major oil market players have their own peculiar nuances that need to be fully understood in order to trade them optimally, and full analyses of these are the subject of this section and the following two sections, beginning with what was effectively the first oil price war from October 1973 to March 1974.

This was broadly based on the idea of cutting off unrestricted access to oil from the world's key suppliers to the world's key importers, causing prices to spike. The next two oil price wars, from 2014 to 2016 and again in early 2020, were broadly designed to flood the global market with excess oil supply, causing prices to crash.

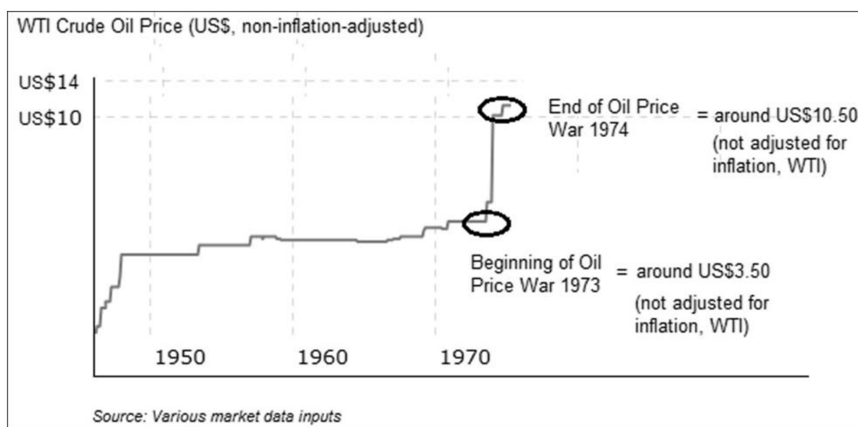
In all three cases, though, the basic objective was the same: to shift and consolidate power to one group of countries (those whose main economic driver was oil exports) from another (those with a wider set of economic drivers but which nevertheless needed significant oil supplies to function optimally).

Because what was at stake for so many of the countries on each side of the oil price wars was so great – in some cases, the continuation of some of their core political and economic structures at the time – the commitment of each side to its own strategy and tactics was absolute.

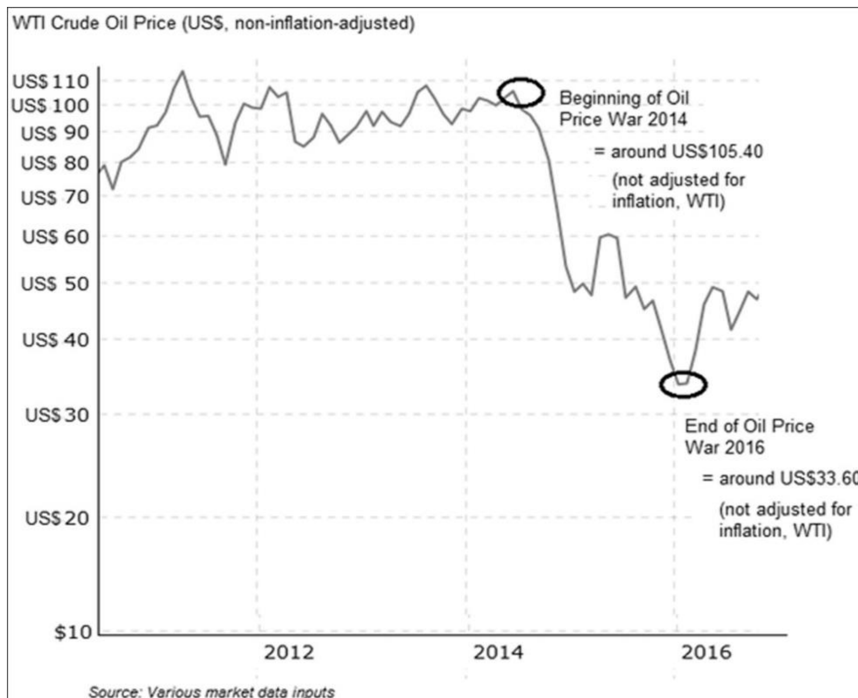
Due to this, the corollary effects on the oil price were enormous, with huge virtually unidirectional trends, from which massive profits could easily be made.

These oil price wars are described in detail in this book because something similar is highly likely to happen again soon so spotting the signs of an imminent oil price war allows any trader to sell (in the manner of the last two) or buy (in the manner of the first one) oil sufficiently ahead of time to maximise returns whilst minimising risk. The effects on price of the three previous oil price wars are shown on the next page, before a detailed analysis of each. The 1973/74 oil price crisis is characterised as a war because, although it was extremely one-sided, it did mark the first major occasion when one group of countries (the OPEC producers in this case) decided to use oil as a weapon to effect a sea-change in their relations with the major buyers of oil.

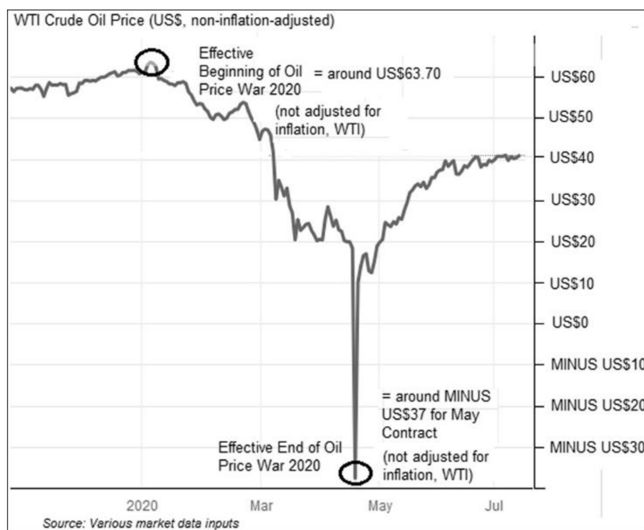
First Oil Price War (1973/74)



Second Oil Price War (2014-2016)



Third Oil Price War (Early 2020)



The Oil Operating Landscape Before The 1973/74 War

The 'Big Three'

It might reasonably be said that the 'modern' oil market began in the middle of the nineteenth century, when the notion of refining paraffin from crude oil took hold, or later that century when John D. Rockefeller's Standard Oil (which became ExxonMobil) held a near-monopoly over the US's refining capacity and its pipeline network. At the other side of the world at around the same time, Royal Dutch Petroleum was conducting exploration and development projects across the Dutch East Indies and then similarly integrating its production, refining and pipeline operations, before amalgamating with the UK's Shell Transport and Trading Company to form Royal Dutch Shell (Shell) in 1907.

One year later, and around seven years after being granted a 60-year concession to search for oil and gas across a large part of Persia (including modern day Iran), William Knox D'Arcy's faith in his chief geologist on site, George Reynolds, paid off with a huge oil strike in the Masjed Soleiman field, and the Anglo-Persian Oil Company was founded. In 1914, a 51% stake in the company was bought by the UK government and in 1954 it underwent a name change, to the British Petroleum Company.

'Operation Ajax'

A portent of the geopolitical chaos that the pursuit to control oil – its excavation, transport and sale – would cause from then on came as the Iranian parliament voted in March 1951 to nationalise the British company controlling the Iranian oil sector on the basis that Iran was only receiving 16% of the profits from the sale of its oil. Shortly thereafter, the domestically highly popular Mohammad Mosaddegh was elected prime minister, nationalising the UK company's local infrastructure assets, and renaming it the National Iranian Oil Company (NIOC). By the

end of 1953, through a military coup organised jointly between the UK's Secret Intelligence Service (SIS) and the US's Central Intelligence Agency (CIA) – respectively codenamed 'Operation Boot' and 'Operation Ajax' – Mossadegh had been removed from power and imprisoned, replaced by the new government of General Fazlollah Zahedi. This allowed the Shah, Mohammad Reza Pahlavi, to increase his hold over the country, backed particularly by the US.

The fact that all of this looks like it has come straight from a spy novel ably illustrates that the oil market is so crucially important to virtually all of the world's economies that nothing in the way of the darkest arts and manipulations that governments and their agencies can think of are off the table. It also means that if the trader knows what the endgames of each of the key players in the oil market are then there are massive profits to be made whilst taking very little risk.

The 'Seven Sisters'

This 'statement of intent' coup allowed for the growing influence of the 'Seven Sisters' group of major international oil companies (IOCs) that were able to control oil development, excavation, transport and pricing for decades, up to the 1973 Oil Price War in fact. The 'Seven' were two of the aforementioned three companies – Anglo-Persian Oil Company (now BP) and Royal Dutch Shell (RDS) – plus three of the iterations of Standard Oil (Standard Oil of California, Standard Oil of New Jersey and Standard Oil Company of New York), plus Gulf Oil and Texaco. Give or take the odd hiccough, most notably the UK/US coup in Iran, these seven companies controlled at least 85% of the world's petroleum reserves, having often paid the host countries a minimal percentage of the resulting sales profits in return. In this context, Iran's pre-1951 oil profit share of 16% looks positively generous when compared to Standard Oil's payment of USD275,000 in April 1933 (equivalent to around USD6 million in 2020) to Saudi Arabia to secure the exclusive rights to drill across the entire country.

This said, the Seven Sisters' fixes were often unilateral and designed to increase one company's market share not just at the expense of the host countries but also at the expense of each other. In the case of the former, for example, in 1959 the IOCs reduced the posted price for Venezuelan crude by USD0.05 per barrel (pb) and then by USD0.25 pb, and that for Middle Eastern crude by USD0.18 pb, without consulting the host countries. In the case of the latter, meanwhile, in August 1960 Standard Oil (also with no warning to its suppliers) announced a cut of up to 7% of the posted prices of Middle Eastern crude oils, without notifying any other company in the Seven Sisters group.

The influence of this group began to markedly decline with the formation of the OPEC cartel in 1960, analysed next. It was exacerbated by the corollary growing power of the big state-owned oil companies in non-OECD countries, especially those of the Middle East.

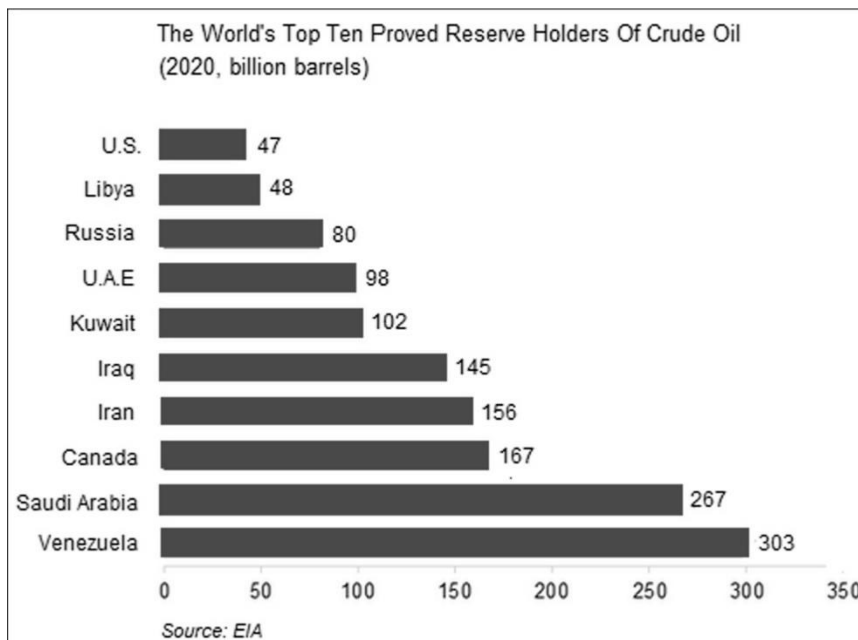
OPEC

On 14 September 1960, the Organization of the Petroleum Exporting Countries (OPEC) was founded with the specific intention to 'co-ordinate and unify the petroleum policies' of all of its currently thirteen member states. These are – in alphabetical order, not that of oil output – Algeria, Angola, Equatorial Guinea, Gabon, Iran, Iraq, Kuwait, Libya, Nigeria, the Republic of

the Congo, Saudi Arabia, the United Arab Emirates (UAE) and Venezuela. Countries commonly thought to be members but which are not include Indonesia, Qatar and most notably Russia.

This 'coordination' means aligning the production, sales and pricing policies of its members: in other words, doing its utmost to fix the global oil price one way or another. Given that its members account for around 40% of the world's crude oil output, about 60% of the total petroleum traded internationally from their oil exports and just over 80% of the world's proven oil reserves, OPEC's influence on the global oil market has been profound since its formation.

The Real Oil Reserves Figures Are A Matter Of Intense Debate



For nearly 55 years, what OPEC did (in terms of collective output, geographical sales policies and pricing) and what it said (in terms of future projections for each of these factors) played the key part in determining the global price of oil and related products such as natural gas, liquefied natural gas (LNG) and all other petroleum products. In the most basic terms, if OPEC decreased oil production, all other factors remaining equal, then the price of oil and related products rose, and if it increased production then the price fell, according to the usual laws of supply and demand.

Additional influence was brought to bear on the oil price when in the 1980s OPEC started to set production targets for its members as well, in that at that time – even if production was running at the high end but comments from key OPEC figures pointed to lower production targets to come – then the price would still be held up to a greater degree than otherwise would be the case.

So, in effect, this move from the 1980s onwards allowed OPEC to have the best of both worlds: high production but also higher prices than the supply/demand balance might otherwise occasionally imply. This situation continued until Saudi embarked on its first major oil price war with the principal objective of destroying the (then-nascent) US shale oil sector in 2014. This will be examined in depth later in this section.

OPEC's 'Swing' Producer' Saudi Arabia

For many decades, Saudi Arabia was the undisputed king of the global energy complex – the world's 'swing' producer – sitting atop OPEC, propped up by its own supposedly massive high quality oil reserves and able to extend its petro-powered influence into all areas of the world's economy, from the trajectory of the US dollar, through the price of gold, to the performance of the leading equities indices and beyond. Much of this power was founded on its *de facto* leadership of OPEC and much of that, in turn, was founded on what it did in 1973/74, as below.

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