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"Whatever it takes…"

This was the promise of the Saudi Oil Minister when asked what his country would do to increase crude prices. This statement was made in May of this year and crude prices have not reacted accordingly- they have gone down. Was it an empty promise? Will or can the Saudi's make a difference as they have in the past? It is hard to imagine that without some sort of agreement to curtail production amongst OPEC producers oil prices will remain in a narrow range. Few analysts are bullish and most seem to reduce their price estimates the lower oil goes. While predicting the future consistently is close to impossible, the one thing we have learned is that the majority of investors are rarely right. So from a contrary perspective, could the price of oil surprise everyone this year by moving higher?

Why is this important? The TSX/SP index is heavily weighted towards energy companies. A sustained price increase for crude, under normal circumstances, would move our index even higher. Higher crude prices would help strengthen the economy though, as we have recently found out, the Canadian economy is doing well enough that the Bank of Canada is expected to increase interest rates imminently. As we look at the various factors that might propel crude prices higher two, very different, scenarios are emerging. From one perspective, many producers are suffering and there may be a natural rebalancing of demand and supply forces. From another, Middle East tensions are increasing. If the latter unfolds in conflict higher crude prices may occur rapidly and, if sustained at these high levels, may actually hurt many major economies.

Most crude bears point to increase US shale production and the quickly increasing production levels by Libya and Nigeria whom are both exempt from the OPEC production curtailment agreement. Demand for crude doesn't seem to have increased enough to date to overcome the OPEC production limits and inventories, to date, show none of the decline eagerly anticipated by OPEC. Of course, this could all change quickly. Oil production has slowed in the US and there are signs of strain by other producers. Venezuela, for example, produces approximately 2

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million barrels per day but their economy and supporting infrastructure are frail. Neil Dwane, CIO of Allianz Global Investors, stated that he considers Venezuela's entire production could falter "any day". Violence in Libya has increased significantly in July according to Reuters which could lead to significant interruption of production. Nigeria is also experiencing increased threats from former militants which may lead to further production issues. But the most significant threat to a potential price increase is the increased tension in the Middle East.

Saudi Arabia and the UAE have recently severed all diplomatic ties to Qatar- a relatively small producer- and many neighbors are aligning themselves with either side. Egypt is siding with the Saudi's, Iran with Qatar. The new Saudi Prince Mohammed bin Salman is certainly more hard line than his predecessors when it comes to foreign policy. The demands made by Saudi to Qatar appear so onerous that an even a partial concession is unlikely creating a potential standoff in the region. While the US is delivering conflicting messages, from the White House and diplomatic core, there are no other superpowers trying to broker a settlement. Thus, chances of tensions escalating are increasing. If these tension lead to conflict, higher crude prices may be the least of our worries as the geo-political landscape could change dramatically.

From a less stressful perspective, it would appear that many Big Oil companies are reducing their investment ambitions in new projects. The CEO of Suncor (Canada's largest Oil company), made an interesting comment recently in a Wall Street Journal interview where he reiterated his comfort level with their present operating model with the projects in hand but stated that he had "no plans to be going ahead with major capital investment in either mining or in situ in the foreseeable future." He went on further to suggest that mining investments are "coming to an end not just for Suncor but for the industry for a considerable period probably in excess of 10 years." If he is accurate then it would appear that future exploration and production by "the industry" will be reduced significantly. This will obviously trickle down and if this represents the thinking of an industry leader it may spillover to lenders and financiers such as major banks. If investment lessens, future crude supplies may not be as plentiful as presently anticipated.

It is also important to remember that decline rates are significant amongst many of the US shale plays. If industry investment is reduced in future projects, decline rates will have a more dramatic effect on the demand/supply equation. If an escalation of Middle East tensions is avoided, there still may be hope for further rebalancing. Libya and Nigeria will be able to produce only so much oil before their infrastructure will be at capacity. With crude at present levels there may not be enough for them to reinvest so they, in turn, may be interested in becoming more accommodative in terms of curtailing production.

Certainly the present perspective is that crude prices will remain in a limited range until, or if, the demand/supply forces become more favourable. OPEC wants higher prices as does the oil industry. We just hope if, or when, Saudi's pledge to do "whatever it takes" will be through peaceful policies.