

Will oil prices continue to rise in 2018?

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Finally things came together for the oil market after a three-year slump characterised by a sharp fall in prices, and their subsequent stagnation at relatively low levels. From June to December 2017, the price of Brent climbed by 40%, breaking the \$60 per barrel barrier for the first time since mid-2015.

Most of this increase is explained by demand. In the second half of 2017, the economies of the United States, the European Union, China and India registered solid growth that led to an increase in demand for oil and its derivatives. The supply side also helped prices to recover, thanks to the discipline exercised by OPEC and its partners after the agreement to cut their production by 1.8 million barrels per day.

In developed economies, crude inventories have declined steadily, although they continue at levels above their five-year average. In addition, the adjustment in inventories has been encouraged by the behaviour of the futures curve, which has assigned a higher premium to short-term transactions, a situation known as backwardation.

The available evidence suggests that oil prices will continue to rise in 2018. The global economy will remain on course for growth stronger than the long-term trend. Meanwhile, the agreement to reduce production will remain in force throughout the year. This will contribute to price hikes and further reductions in inventory levels.

The development of fundamentals is compounded by elements of geopolitical uncertainty, which could restrict supply in the short term and exacerbate the rise in prices. Among these are: tensions between the Kurdish independence movement and the central government in Iraq, as well as the likelihood that the United States will impose new sanctions on Iran, after the Trump administration refused to certify the nuclear agreement. Furthermore, the evolution of both the anti-corruption campaign and the ambitious reform agenda being led by the Crown Prince to the throne of Saudi Arabia could add volatility to the market in the short term.

But perhaps the greatest uncertainty is the speed at which supply will respond to higher prices. The shale oil industry in the United States and other producers around the world could increase the supply in a relatively short period of time. The above suggests that, although OPEC has managed the cycle reasonably effectively, the struggle to gain market share will make it difficult to keep prices above \$60 per barrel on a sustained basis.

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