Mystery of my **oil price forecast**

Adam Pilarksi, senior vice-president at Avitas, looks forward to 16 October to show that his long-term – or is it short-term? – forecast was correct.

The date 16 October 2018 is approaching and I get a lot of messages reminding me of a forecast I made at the annual Istat meeting in March 2011 regarding the future of oil prices. At that time, oil prices were considerably more than $100 a gallon, reaching $147 in July 2008. Most people in the industry firmly believed high (and continuingly higher) oil prices would stay forever. A remark by Willie Walsh, chief executive officer of International Airlines Group, that he would be purchasing aircraft with the assumption that oil prices would forever be exceeding $150/gallon led me to react.

Such assumptions about long-term oil prices will necessarily lead to sub-optimal fleet selection if, as I firmly believed, the oil price forecasts were fundamentally wrong. Oil prices are historically very volatile because of significant political factors affecting oil production levels – also the oil markets, as clearly emphasised by the existence of a powerful cartel (Opec) using conscious direction to manipulate the markets.

On the other hand, the accepted belief that “we are running out of oil” is plainly wrong. We have today 56 years of oil left, while in 1954 we had only 32 years of oil remaining. So, the more oil we extract, the more we have left. Some oil analysts are changing the question today from the old one of “what will we do without any oil left” to “what will we do with the stuff in the ground when we no longer want it?”

Like all other forecasts, we can differentiate between short and long term. In our industry, short-term forecasts use different techniques but are critical in predicting airline profitability or whether oil price hedging is a good strategy. Long-term forecasts help us decide what kind of aircraft to design, build and purchase. When oil prices were more than $100/gallon, the industry assumed such a level would remain for a few decades. Hence, designing and purchasing the most fuel-efficient aircraft was the proper strategy. If, on the other hand, the oil price level is only temporary, there is no need to restructure the fleet to a more efficient one but concentrate on other options to maximise profitability under temporarily high oil prices. In my view, when making the Istat prediction a large part of the industry accepted the short-term forecasts as the appropriate long-term one.

Our author at the 20th Global Annual Airfinance Conference in Dublin

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The obvious question is what is short versus long term. Simply, long term is often seen as a few decades, a long time away. Or when the reader or forecaster will be retired or in another job. Or, as Lord Keynes said: “In the long run we are all dead.” The term long term is generally not taken too seriously. When confronted by such a term, the reader usually is interested to know “what exactly do you mean by long term?”

Accepting general long-term statements such as: “By the year 2039 there will be demand for 45,678 aircraft” is often met with scepticism. In 2011, I was quite confident that oil prices would drop below $100/gallon “in the long run”. And that such a forecast was very meaningful for our industry and would bring dramatic changes to all concerned. As expected, nobody liked the term “in the long run” – hence, everybody wanted a quantification of the specific date. My analysis led me to believe that oil prices would definitely fall below $100/gallon and even, at some time, below $40/gallon. Hence, my forecasts specified an eventual drop to below $40/gallon. The timing I identified was not as before “in the long run” but specifically tied to the launch of the Neo and even the Max series, which was not yet launched. While this was more precise than before, many people still wanted a precise date. I selected the date I knew I would not forget: my 70th birthday, 16 October 2018.

So what has happened? Oil prices stayed at the $100/gallon for a time and then started falling until they went below $40/gallon on 24 August 2015. My prediction re oil prices below $40/gallon materialised almost 100 times.

Right now oil prices have been rising and are in the neighbourhood of $70/gallon. This is the reflection of a number of political factors. Some reflect demand shortages (upheaval in Venezuela, restrictions on Iran), some are a cooperation of Russia and Saudi Arabia related to political developments in the Middle East, and some the forthcoming initial public offering of Saudi oil company Aramco, which is worth potentially $2 trillion. The existing $70 price is a temporary phenomenon and, in the long term, I am fairly confident that my forecasts over the years were accurate – even right now some who hedged will lose money.

In the true long term, I believe that oil prices below $40 are more likely than above.