OPEC sees oil prices exploding to $200 a barrel

Matt DiLallo, The Motley Fool *4:28 p.m. EST February 3, 2015*

(Photo: Charlie Riedel, AP)

Right now the oil market is totally focused on finding a bottom for oil prices. However, according to OPEC's Secretary-General Abdulla al-Badri we've already hit bottom. Not only that, but he sees a real possibility that oil prices could explode higher to upwards of $200 per barrel in the future. He's far from the only one that sees a return of triple-digit oil prices.

Finding a bottom

According to the Secretary-General, speaking in London on Jan. 26, the oil market doesn't need to look for oil prices to bottom as the market has already bottomed. Instead, he offered quite bullish comments by saying, "Now the prices are around $45-$55, and I think maybe they [have] reached the bottom and we [will] see some rebound very soon." Now, normally that type of remark would be just another layer of noise, but this is coming from OPEC's Secretary-General so it comes with a lot of weight behind it.

That said, he's not saying that OPEC will come in and rescue the oil market by reversing its previous decision to hold steady on production. Instead, he sees the signs that the oil market is self-correcting as oil companies have made deep cuts to spending, which will eventually lead to lower production growth. Further, the rig count in the U.S. is plunging, which is usually a key to a bottom in oil prices. However, in the midst of cutting back as the industry works through the current oversupply the Secretary-General is now warning that the industry is putting future oil supplies at risk by under investing today.

Underinvestment leads to a shortage

The Secretary-General said that, "if you don't invest in oil and gas, you will see more than $200" when it comes to future oil prices. While he didn't give a timeframe, he did note the correlation between investment and future production. This is because oil production naturally declines and oil companies need to invest in new production to not only replace this decline in production from legacy oil fields but to add new production to meet growing demand. However, oil companies are reluctant to invest in new production as their cash flows decline.

Over time this could become a problem as oil fields around the world naturally decline by an average of about 5% per year. In order to overcome this decline oil companies need to develop about 200 billion barrels of oil supplies over the next decade and a half just to meet demand.

These supplies will require the industry to invest $7-$10 trillion. However, with the big capital budget reductions oil companies have announced this year it could make it harder for the industry to meet future supply needs. In fact, the industry might defer up to $150 billion oil projects this year due to the collapse in crude prices. Many of these investments, however, wouldn't have yielded actual production for a couple of years due to the long lead time of major projects.

As an example, Chevron delivered first oil on two of its Gulf of Mexico projects late last year after beginning construction on the fields in 2011. Meanwhile, another $6 billion project it just sanctioned at the end of last year won't produce any oil until 2018. It's these long lead time projects that are being delayed, which is setting the world up for higher oil prices in the future as an under investment today has the potential to lead to a constriction in future supplies.

Investor takeaway

OPEC's Secretary-General is calling the bottom in oil prices. While he's not the first to call a bottom, he does lead the organization that currently controls the oil market so his comments do have a lot of weight. Further, he's also suggesting that the cuts that oil companies are making could have a dramatic impact on future oil prices as the under investment has the potential to cause oil prices to rocket higher if demand grows faster than future supplies. That, however, would all be part of OPEC's plan as it purposely pushed for lower oil prices now so it could control market share once oil prices surged in the future. It's willing to endure short-term pain for the potential of a big long-term gain.

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