



The Last Oil Price Boom May Be in Sight

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Are we on the cusp of a new oil price supercycle?

As a result of the COVID-19 crisis, conditions are ripe for a boom in oil prices during the next two years. We see high potential for the rollout of national vaccination programs to unleash huge pent-up demand for oil in key areas of the global economy, potentially boosting demand growth to the highest levels in oil's history. This surging demand will coincide with a supply shortfall created by producers that cut capital expenditure (capex) sharply when prices fell in 2020.

Given the rapid development of the upcoming boom, the next supercycle will likely occur on a time scale that will be shorter than the ones associated with prior price booms. (See Exhibit 1.) This quick rise will put pressure on suppliers, which will expand capex to meet rising demand, and end users, which will leverage efficiency as well as increasingly available new technologies to mitigate—or even avoid altogether—the price of oil and its attendant emissions.

Exhibit 1 - The Upcoming Price Cycle Will Be on a Compressed Time Span



Source: BCG Center for Energy Impact.
 Note: The 2008—2014 price boom was in fact composed of two booms—one in 2008 and another in 2014—but we are treating them as one longer term event.
¹Market adjustment is defined as the longer-term changes made to supply and demand in order to create a new balance.

We therefore see a high probability that a price boom will occur but also that it could be over quite quickly—within 18 months, or even less. Perhaps more important, this oil boom could be the world’s last. The oil market system continues to become more flexible, with both supply and demand more elastic than in the past, making booms less likely to happen. And even if they do occur, peak prices are likely to be lower.

Energy transitions are also underway as policymakers and companies seek to curb emissions and tackle climate change, slowing the rate of growth in demand. At the same

time, higher prices, even if they last for short periods of time, will spur further investment in alternative fuels and accelerate movement away from fossil fuels.

Savvy oil and gas companies will grasp the opportunities created by rising prices to repair their balance sheets, refine their strategies, and—in some cases—turbocharge investment in lower-carbon energy businesses. But they will need to avoid overspending and jeopardizing their future competitiveness. Heavy users of oil will have to take steps to mitigate the impact of higher fuel costs on their bottom line.

OIL DEMAND COULD SOAR

As for any commodity, keeping demand and supply in balance—or close to it—is essential for stable oil prices. Since their 2020 low point, when a pandemic-induced slowdown in the global economy caused demand to slump, prices have risen as economic activity has started to pick up. We expect that trend to accelerate due to an emerging imbalance between demand and supply.

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Oil demand has the potential to rebound strongly as the world recovers from the COVID-19 crisis—provided the US continues to rapidly vaccinate its population and programs in Europe and the rest of the world catch up. As vaccinated individuals resume many of the ordinary activities denied to them over the past year, oil demand

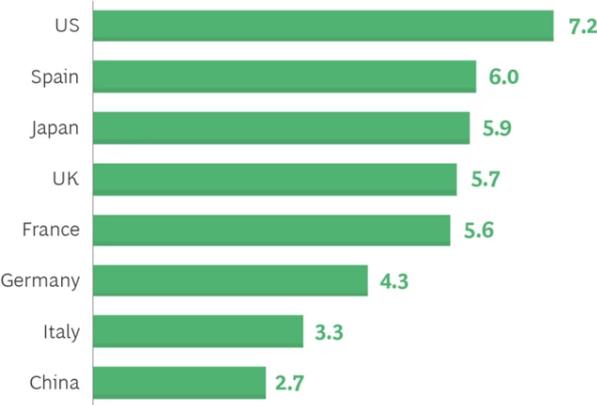
could experience one of its strongest-ever growth periods. Several emerging themes could drive oil demand sharply higher.

Consumer interest in travel is growing. Leisure travel, which depends on oil for fuel, is the top spending priority for US consumers in 2021, according to a survey by American Express. (See Exhibit 2.) This increased desire to travel is confirmed by BCG’s Lighthouse platform, which uses **artificial intelligence** to forecast future demand patterns. Lighthouse

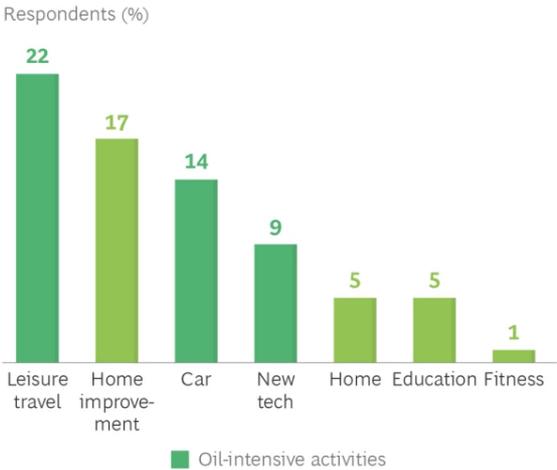
has found that US consumer interest in hotels and airline bookings rose sharply in the first quarter of 2021, which will help boost jet fuel demand, the one major fuel still well below pre-pandemic levels (it is not expected to fully recover until 2024). It will also stimulate ground transportation and boost demand for gasoline and diesel, as consumers seek to reconnect with family members in distant places.

Exhibit 2 - With Significant Savings Accumulated, US Consumers Are Primed to Spend

Excess savings as a share of GDP (%)



Top purchases that consumers are saving for in 2021



Sources: American Express; BCG.

Note: For the company’s December 2020 Amex Trendex report, American Express polled 2,000 US adults who traveled by air at least once in 2019 and had an annual household income of at least \$70,000. Respondents were asked what they anticipated their top big purchase in 2021 would be.

Travel demand has already begun to soar in areas where trips are once again allowed. Both China (the first country to recover from the pandemic) and India, for example, experienced rising oil demand after they initially removed lockdown curbs and reopened their economies. Demand for oil is close to or above pre-crisis levels in these countries, although in India, the subsequent rise in infections and reintroduction of restrictions, among other factors, will likely check the demand recovery going forward.

Substantial savings exist. Fueling the pent-up demand for leisure travel and other oil-dependent activities are the substantial savings amassed by global consumers during lockdown. In the US, personal savings account for about 18% of disposable income—three times the amount during the recession a decade earlier. According to our calculations, if

all the savings accumulated so far during lockdown were spent in one year, the US economy would grow by more than 8%, a rate not seen since the early 1950s.

The global economy is recovering. Given the underlying health of the global economy, combined with pent-up demand and sizeable discretionary funds available to meet that demand, global economic growth is set to boost oil consumption over the coming years. According to the International Monetary Fund (IMF), the global economy will grow by 6% this year and by about 4% in 2022, helped by massive fiscal stimulus packages in the US and many other countries. Clearly, the pandemic has left its mark in terms of the human cost of the crisis in fatalities and job losses. But it has had an impact in other ways as well, boosting e-commerce at the expense of more traditional sectors and changing how people work. Unlike the financial crisis of 2007 to 2008, which damaged large parts of the global economy and left a legacy of weak growth that lasted for a decade, the exogenous shock of the pandemic hasn't wrought lasting damage. By 2024, most advanced economies will have returned close to their prepandemic growth path, according to the IMF.

Companies are reconfiguring supply chains. The move among manufacturers to rethink their [supply chain strategies](#) could also stimulate oil demand as they shift from “just in time” procurement methods to “just in case” and increase their inventories. Companies that were working with lean inventory and just-in-time methods during the pandemic suffered the greatest negative impacts. Social distancing, illness, and lockdown restrictions disrupted systems that depended on the right part being delivered at the right time. The global supply chain is not invulnerable—as the container ship recently stuck in the Suez Canal made clear—and it will be important to boost inventories above prepandemic levels. Transporting more products and components to fill inventories will require more oil as fuel to meet rising demand in multimodal transport.

SUPPLY MAY BE INSUFFICIENT

Spending cuts during the pandemic also threaten to create serious supply problems for the future if, as we expect, demand soars. Oil and gas companies reduced investment in their upstream businesses by 34% in 2020 following the pandemic-induced decline in demand. And investment levels are expected to remain low in 2021 as companies continue to

control spending in a bid to bolster weak balance sheets and maintain their financial discipline.

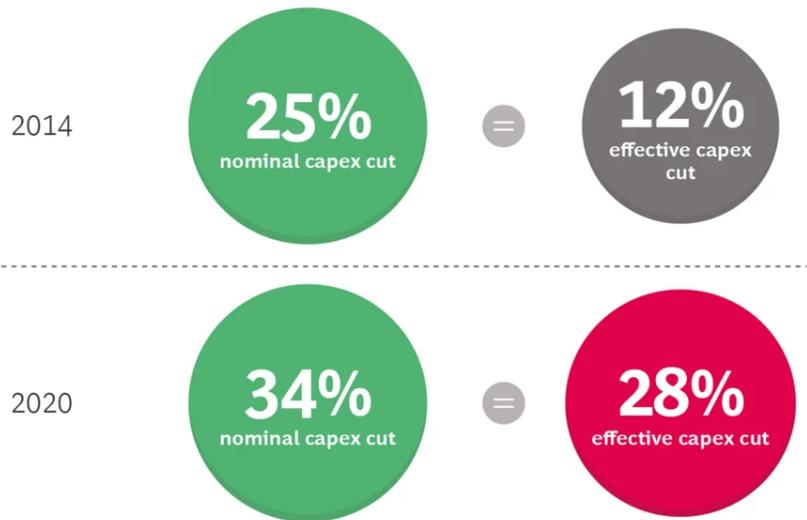
At the height of the pandemic lockdowns, weak oil demand inflated crude and oil product stockpiles to more than 600 million barrels per day (mmb/d). But these stocks have fallen by a rate of about 2 mmb/d since the beginning of 2021 and will return to historical levels as demand picks up, leaving the industry at risk to meet the world's growing appetite for oil. This scenario, combined with a rebound in demand, would drive oil prices sharply higher. Market concerns that global stocks are too low, or that OPEC's ability to boost capacity is insufficient, could fuel the price increases.

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In 2020, a \$1 cut in upstream capex reduced activity by 87 cents—more than twice the impact in 2014.

The reduced investment levels are set to have a greater negative impact on the economic activity of the oil and gas industry than they did the last time operators made significant cuts to capex—in 2014. (See Exhibit 3.) This is because the current reductions are larger than those made six years ago. What's more, in 2014, service sector companies lowered their costs sharply, helping to support ongoing industry activity. Consequently, a \$1 cut in upstream capex diminished activity by just 34 cents. In 2020, by contrast, service companies had less scope to cut costs and reduced their expenses only slightly. Consequently, a \$1 cut in upstream capex reduced activity by 87 cents—more than twice the impact in 2014.

Exhibit 3 - 2020 Capex Reductions Had a Larger Impact Than Those in 2014



Source: BCG.

THE BOOM REMAINS UNCERTAIN

Several factors could affect the timing of a boom and either curb or exacerbate future price rises. Lingering lockdown restrictions have kept global demand at close to 7 mmb/d below 2019 levels since October of 2020. Further restrictions, or the appearance of new COVID-19 variants, could immediately halt any upward movement in demand—delaying or even ending any emerging oil price boom.

Global supplies could increase if, as seems likely, the Biden administration were to remove economic sanctions on Iran as part of efforts toward a new international nuclear accord with the country. Iranian production has already risen over the past few months in anticipation of a deal. US shale players, under pressure from their shareholders, have adopted greater discipline about how they spend investor capital recently. But if prices started to rise, they could throw their newfound caution to the wind and boost production to cash in on a rising market.

The actions of OPEC and its allies—a group known as OPEC+, the key organization influencing global oil prices today—will be pivotal to international oil prices. The group is

seeking to increase production at a pace that matches that of the demand recovery (adding back production that was cut in the wake of last year’s demand dip). This is a tricky operation. If OPEC+ gets the timing right, the additional supply would help keep price rises in check by helping to satisfy global demand. But if the group raised production ahead of, or well behind, a recovery in oil demand, it could increase volatility and cause extremes at both ends of the price spectrum.

THE PRICE EXPANSION WILL BE RELATIVELY SHORT LIVED

Uncertainty around how these different forces play out makes it tough to predict when the boom will start or how high prices will go. We will not speculate on potential future price levels. But in terms of timing, an oil price boom based on a fundamental supply-demand imbalance could start as early as the third quarter of 2021 or be delayed until 2022. And there are good reasons to believe that it will not last for decades. Indeed, in our view, it could be over in 12 to 18 months.

Why? Because the oil industry and commodity markets have changed significantly during the past decade. The supercycle prior to 2008 had its origins in the 1980s, when lower prices caused a reduction in investment. These cuts allowed a semblance of market balance until the early 2000s, when oil producers faced a sharp rise in demand, particularly in Asia—a situation that was ended by the global financial crisis of 2007 to 2008 (and oil prices exceeding \$150 per barrel). Since that time, the industry has become far more responsive to changing external conditions. Here’s how:

- **Oil production projects are both faster and smaller.** Rapid drilling techniques developed during the shale revolution have helped other asset types, including large offshore projects, to reduce the time to first oil—in some cases, by as

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much as 50%. Meanwhile, projects have become smaller, speeding up investment decisions and enabling new production to hit the market faster.

- **The industry has reduced upstream costs significantly since 2014.** As a result, twice as much production is commercially viable at \$50 per barrel as was the case then. High prices can still occur, but producers can act more quickly to bring production online as they rise, limiting the potential for sustained price increases.
- **OPEC+ is nimbler than its predecessor, OPEC.** This agility stems from more frequent meetings among its members, with a monitoring group able to determine production levels much faster than in prior eras. And its members are able to bring new production online faster than before, helping to balance market supply and demand. The fiscal breakeven oil price (the price required so countries can meet their spending needs while still balancing their budgets) of several key Middle Eastern members has also fallen as a result of austerity measures and economic policies; in Saudi Arabia, for example, it has dropped by \$10 per barrel over the past year. These countries are also mindful of the negative effects of high prices on both the global economy and the energy transition, and they consider high prices to be counter to their long-term interests.
- **Changes in oil prices impact demand more quickly now than in the past.** This is largely due to a reduction in government subsidies and state measures in developing countries that influenced or controlled the price of oil products, such as gasoline. Because consumers have greater exposure to the real price of oil, they are more likely to lower their consumption when prices rise. In India, where state controls have been removed in recent years, a combination of high taxes and the rise in oil prices since mid-2020 have blunted the growth in the demand for oil despite a rapidly expanding economy. The options for modifying oil demand around the world will also be greater in a postpandemic environment. The availability and sales of electric vehicles, for example, will increase. In addition, many companies will experiment with new ways of working, such as continuing to implement a hybrid work model of home and office. A period of high prices may also push employees to press for more time working from home to avoid fuel costs.

- **Satellites and other communications technologies have improved the flow of up-to-date information and made the industry far more transparent.** As a result, players are in a better position to act quickly and make informed decisions. Lagged data has always plagued the industry, but now its effect is diminishing.

THE LAST OIL BOOM?

Increased oil consumption will inevitably lead to higher emissions. But we see strong reasons why the oil price boom, if it happens, could be the world's last—a development that would clearly help the effort to [combat climate change](#).

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If the oil price boom happens, it could be the world's last—a development that would clearly help the effort to [combat climate change](#).

More expensive oil will increase the pace of transition away from fossil fuels, especially in countries that need to import oil to meet their energy needs. The International Energy Agency (IEA) in May published a roadmap for the global energy sector to reach net zero emissions by 2050. The IEA said that the pathway, while narrow, is achievable if countries act with

urgency to embrace clean technologies.

We expect these countries, rather than pay costly bills to external oil suppliers, to accelerate investment in renewable energy and electric-vehicle charging networks—in some regions, using postpandemic stimulus programs to rebuild in a more environmentally friendly way. Investing in domestic technologies would also strengthen the security of the energy supply. And in developing countries, greater exposure to real oil prices could hold back consumer demand.

The COVID-19 crisis has also normalized patterns of consumption and ways of working that are less dependent on mobility and oil. Conducting a meeting via a provider such as

Zoom, for example, has become second nature for business professionals. We expect that most companies will continue to use video conferencing after the pandemic, causing business travel to lag the recovery in leisure travel as fewer in-person meetings are needed. These new, more socially distant and stationary approaches to work and shopping could curb postpandemic oil demand and, as they become more established, help mitigate future price booms.

RIDING THE BOOM

Savvy producers and oil-dependent energy users will invest the increased revenue they receive from higher oil prices in a range of measures to strengthen their businesses in preparation for a lower-carbon world. It is essential, however, that oil and gas companies maintain their fiscal discipline and avoid reverting to the inefficiencies and wasteful spending of the past, especially since the period of strong prices will be a short one. These companies need to consider taking three actions:

- **Repair the balance sheet.** Players across the industry will need to repay debt and repair balance sheets that have been decimated by the COVID-19 crisis. Strengthening their finances is a key move for companies in preparation for a postpandemic world that relies less on oil for its energy needs. A strong balance sheet is also important so that companies can provide the dividend payouts demanded by investors. In addition, they will need to rapidly get their finances in order so they can ramp up production quickly, especially from short-cycle projects, in the face of what is likely to be a short-lived price boom. **Service companies**, meanwhile, should take advantage of the positive pricing environment to improve their customer base so they can safely rely on strong producers that aren't in danger of collapsing in the years ahead.
- **Accelerate continuous improvements.** To maintain the viability of oil and gas assets in a decarbonizing world, producers must take steps to reduce the environmental impact of their businesses and strengthen their license to operate. In upstream areas, they can start by adopting measures that reduce methane leakages during production. They should also invest in **digital technologies to improve operational efficiencies, drive down costs, and create value for shareholders**. Digital is critical for companies that want to transform their legacy businesses so they can boost

performance and innovate their business models to tap new value pools. However, we've found that despite making good progress, no oil and gas producer has successfully adopted digital technologies at scale. Indeed, many companies are still in the early stages of implementing digital—even though the potential for cost savings is significant. Companies need to double down on their digital successes and scale up digital initiatives across their businesses. With a variety of toolkits, such as BCG's offshore diagnostic tool, we are working with operators to lower breakeven costs by more than \$10 per barrel of oil equivalent and help first-quartile producers to become industry leaders.

- **Evaluate potential to deploy additional capital toward energy transitions.** In line with existing strategies, companies should look for opportunities to deploy capital in hydrogen, renewables, or carbon capture, utilization, and storage. The pandemic has caused [international oil companies \(IOCs\) to accelerate plans to reinvent themselves for a new energy landscape](#). European IOCs are expanding into renewables and low-carbon energy businesses. Meanwhile, their North American peers are doubling down on oil and gas production while investing in technologies to increase efficiencies and reduce greenhouse gas emissions. The price boom will give both groups additional financial means to either reevaluate their strategies or continue on their current courses. However, they will need to carefully consider how they allocate capital among reinvestment in their hydrocarbon businesses, investment in new energy areas (for European IOCs), and investor payouts—all of which significantly drive value creation.

For industries that rely heavily on oil for their energy needs, such as airlines and shipping, higher prices can pose huge challenges. Fuel accounts for 25% to 40% of operating costs for airlines, and as much as 50% to 60% for ships. As a result, rising oil prices can have a big impact on earnings.

While shipping demand and prices have risen during the pandemic due to increased demand for goods, airlines are bleeding cash and struggling with mounting debt because of the challenging environment they face. In response to a spike in fuel costs, airline network carriers, in particular, would either have to pass on the additional expense to

consumers through higher fares and fuel surcharges or trim unprofitable routes and curb capacity. For low-cost carriers and airlines that have hedged their fuel costs, the impact will be lessened.

Traditional methods available to heavy users of oil to curb fuel use and thus mitigate price increases include reducing weight, readjusting fleet allocation to optimize the use of newer or smaller aircraft and ships that use less fuel, and introducing more fuel-efficient operating procedures such as “slow steaming.” Container ships now travel 20% more slowly than they did during the 2008 oil price spike in a bid to increase efficiency and lower costs.

But now, more innovative and structural approaches are available as well. These include using advanced analytics to optimize routing and quickly identify and fix problem engines or vessels that are rapidly burning through expensive fuel; retiring and replacing vehicles in the fleet more aggressively; using alternative energy sources that depend less on oil to power facilities and ground services equipment; revisiting fuel procurement strategies, including decisions about tankering (carrying excess fuel to reduce or eliminate refueling at a destination) on trips to regions with high fuel costs; and replacing traditional fuel options with fuel from sustainable feedstocks.

As the world emerges from the COVID-19 crisis, an oil price boom is looking increasingly likely. The market conditions that create the boom will also compress its path—with surging demand coinciding with a shortage of supply—and the price expansion will not last long. Despite the boom’s relatively short duration, producers and users of oil will need to plan ahead to tap opportunities to prepare for a postpandemic, lower-carbon era and mitigate the risks of higher prices.

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