

Etsior Monthly Opinion 15 May 2009 - Will oil price soar again?

Well, the question may rather be: When oil prices will soar again?

Crude oil prices are this year hovering around \$50-60 a barrel after we experienced a surge over 147\$ in July 2008, its record price. A lot of people believe oil cannot remain at these levels and that it is time to enter this market again. The reason for the current price level is a lower demand in consuming countries, as recession has taken its toll. Stocks are up everywhere with tankers used as floating stocking facilities. At the same time, investments on exploration sites are being reduced as well on new production facilities. Would this situation be the foundation for the next bubble as soon as the economy starts to recover? Will the massive investments in alternative energies keep the oil price low? What would be the "right" price for oil?

Everybody is talking about **new energies** like wind power, solar energy or bio-fuel. As interesting as they are, we have to realize nevertheless that these energies are still highly subsidized. A high oil price (around \$ 75/barrel) is then necessary for these energies to develop and in the best case they will represent 20 to 25% of the electricity output. The only real challenger is nuclear power generation which provides huge capacities and no CO² emissions.

As output has been reduced and stabilized by OPEC countries, oil prices will start again to rise only when there will be clear and convincing signs of a recovery of the economy. This will probably not happen before 2010, maybe 2011. Given the excess inventory of oil estimated to over 125 million barrels, which by the way represent only 1.5 days of global production, oil price should not be over 65\$ in 2010. Emerging countries will be the ones recovering faster and pushing more and more on commodity prices. Then as investments have been reduced, we will probably see another strong surge in the following years. This demand will be amplified by inflation: Governments have injected great amounts of money in the economy and there is no doubt that at some points this overflow of money will have to be reduced. Inflation will be an apparently painless way of doing it and oil will follow the trend and beyond, providing a natural hedge against monetary depreciation. When recovery is there, the global GNP growth forecast is around 3 to 4% annually. That leaves room for all the new energies, as oil production alone will not be enough to meet the demand. Energy saving and efficiency will be needed as much as ever. Price will reach the mid 2008

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Currently, a great number of actors who want to hedge their procurements at today low prices are also returning to the market and buying futures. Airlines are a good example as they want to secure oil prices which represent a large part of their costs. Refiners and producers are in the same case. The increase in oil prices is already reflected in the volatility: premiums for 2007 futures are over 60%.

In conclusion, oil price will stay more or less at the current levels until mid 2010 at best, but as soon as economy picks up again, especially in emerging country, it will surge to levels already reached, highly helped by inflation. From 2012 on, alternative energy and energy efficiency policies will only help meet additional demand until these alternate sources are mature, abundant and inexpensive enough to keep oil at reasonable prices. The later will happen without any doubts, but probably not yet within the next decade.

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