

Oil Prices: Speculative Bubble or Structural Shift?

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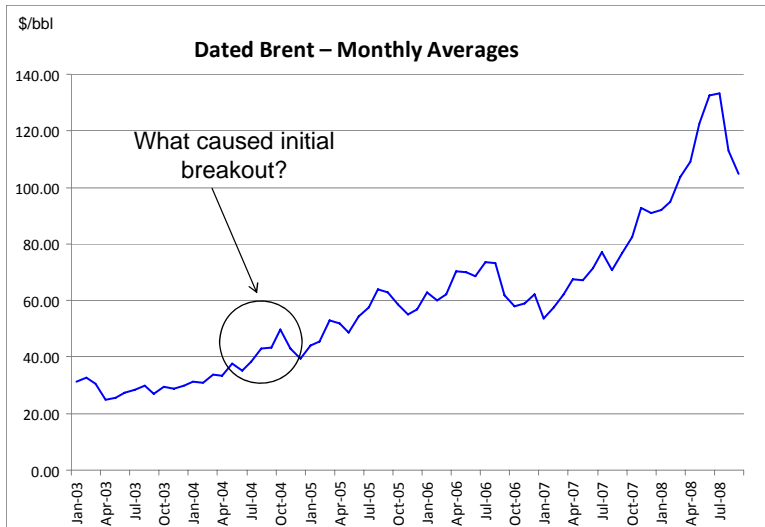


Making sense of the oil market

- From 1985-2003 the oil price averaged \$20/bbl
- Since 2004 it has risen to a likely average of over \$100/bbl this year – yet demand keeps growing and supply concerns remain
- But...in the past 2 months, the price has fallen by \$50/bbl!
- OPEC is cutting production even though the market is not oversupplied
- What is driving prices, is the market rational and where is it going?



Crude oil prices – the new era

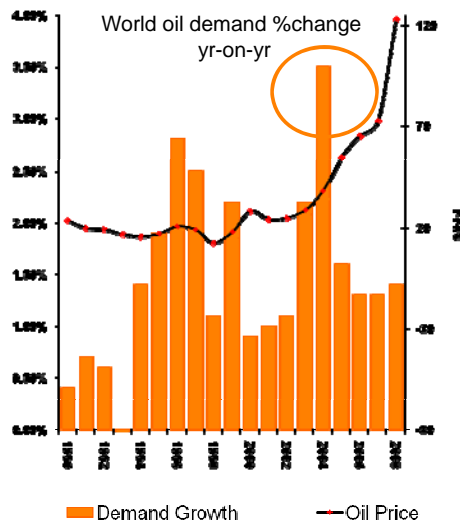


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Why Prices Broke Free



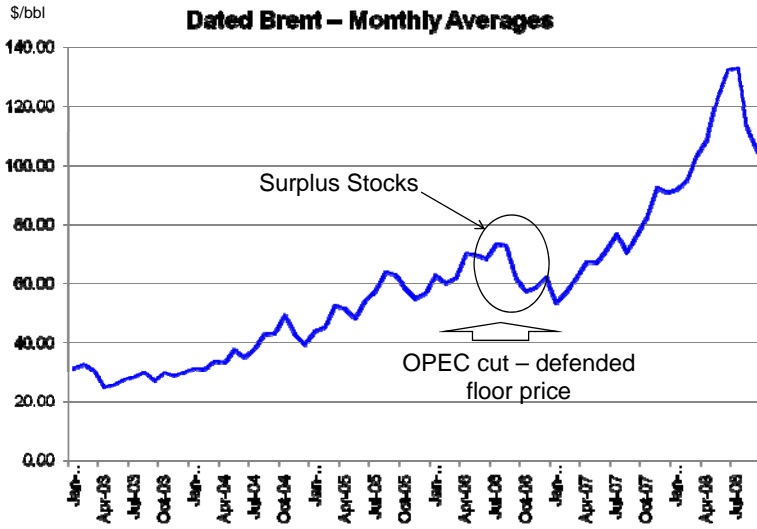
- Demand surge in 2004 exposed capacity constraints throughout oil value chain
- spare crude capacity was "wrong type"
- surplus refining capacity was in wrong place and wrong type
- OPEC failed to contain rise and price band was abandoned

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Crude oil prices – the new era

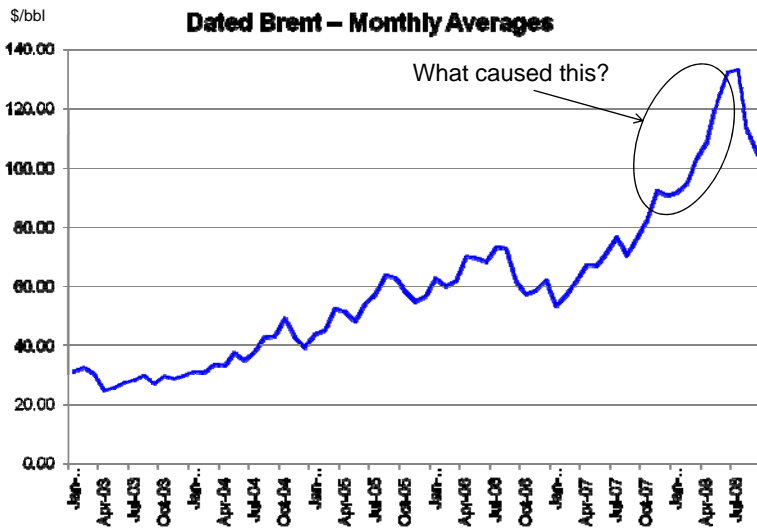


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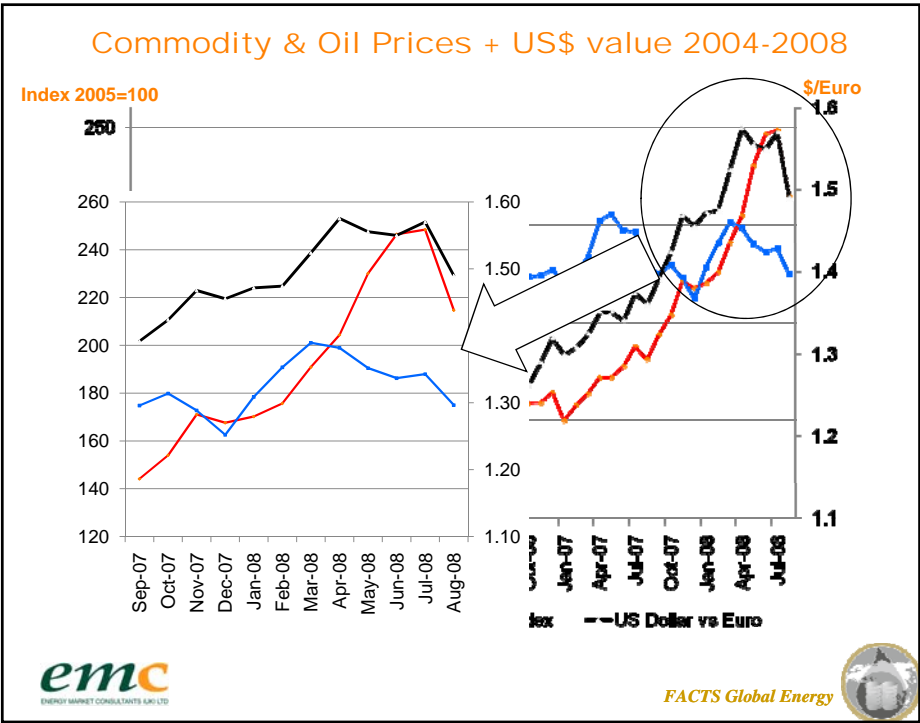
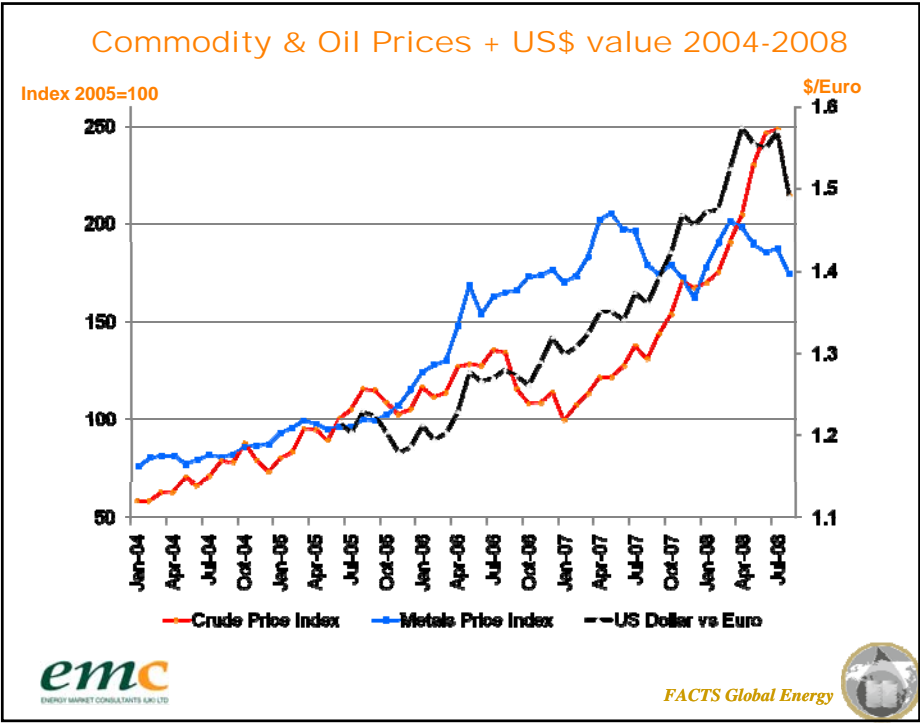
Crude oil prices – the new era



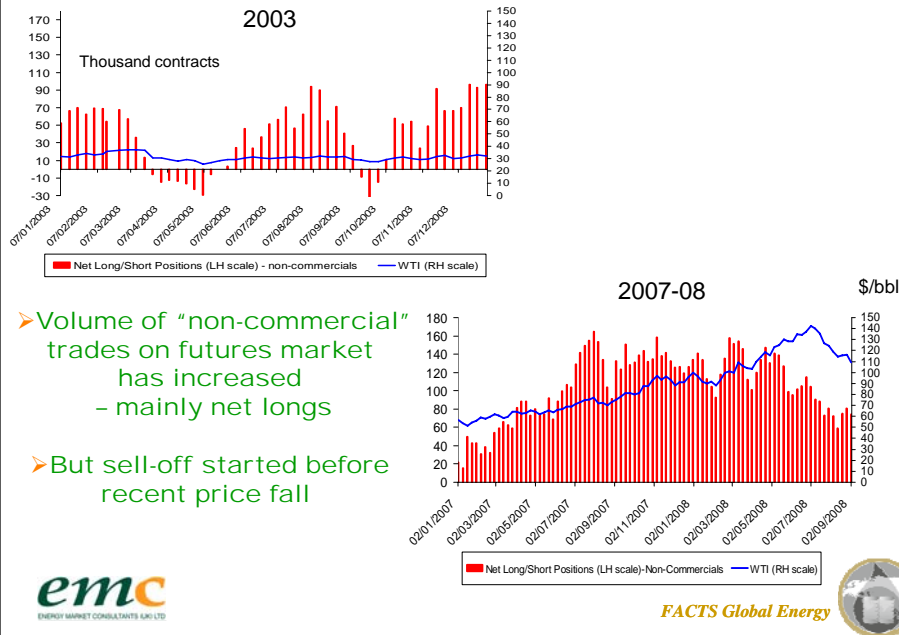
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NYMEX – how important are the “speculators”?



- Volume of “non-commercial” trades on futures market has increased – mainly net longs
- But sell-off started before recent price fall

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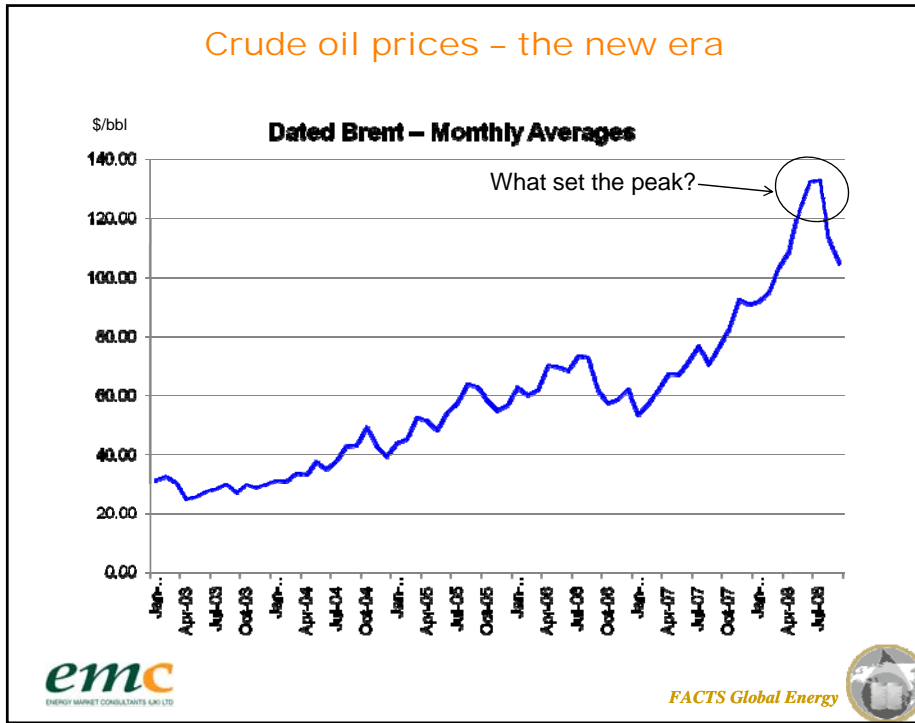
Why was oil so bullish in first half 2008?

- Weakening US dollar
- Switch from other commodities
- Market was seeking price ceiling
- Widespread concern about future oil supplies

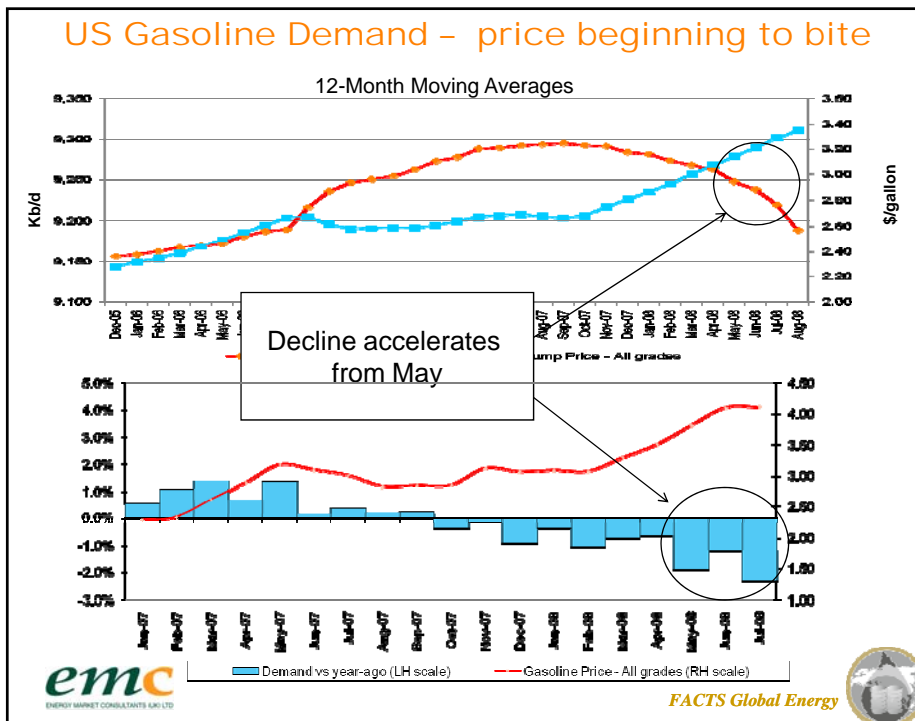
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Crude oil prices – the new era



US Gasoline Demand – price beginning to bite



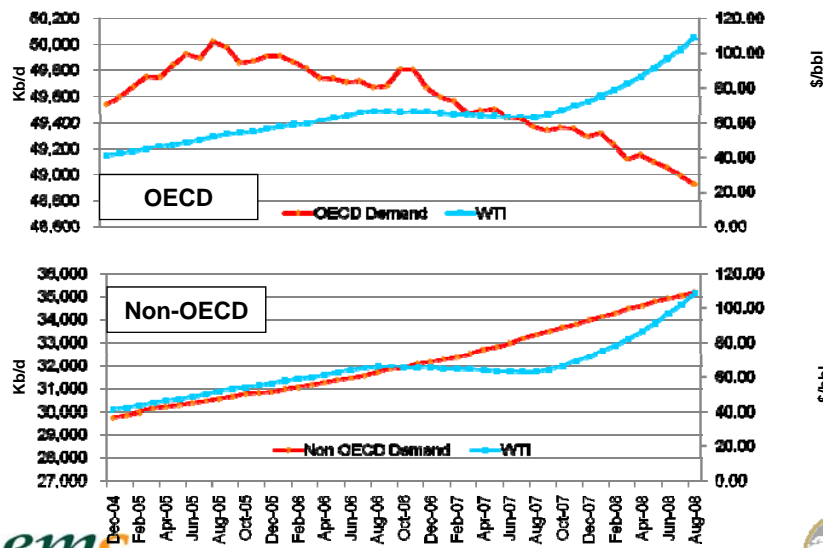
Why US Gasoline is Important

- Total US gasoline consumption is over 9 million b/d, 40% of world total
- Pump prices are less than half the level of Europe
- Per vehicle consumption is over three times the European average
- Average MPG is 60% the European level
- A reduction in US gasoline demand is the least painful way to make short term adjustments to high oil prices

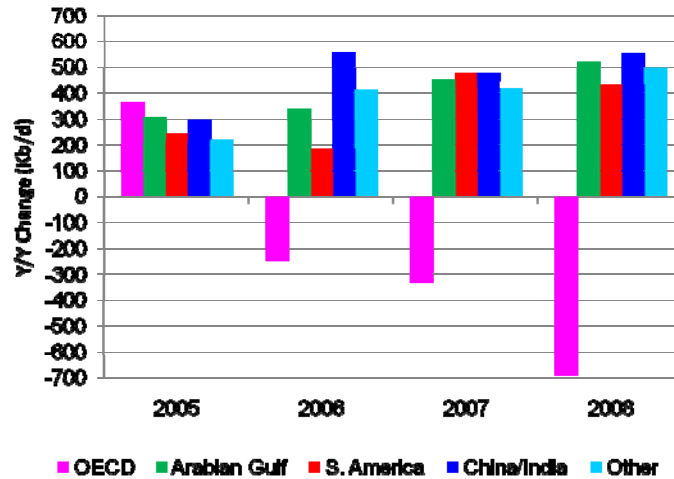


Oil Prices and Demand - A Tale of two Worlds

(Monthly moving avg.)



Non-OECD driving oil demand in high price world



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OPEC now having to set price floor

- Recent price slide is more sentiment-driven than fundamentals (unlike 2006)
- OPEC statements were aimed at "speculative" players
- but.. a cut will be needed by year end?
- OPEC has weak formal quota system - and no official price floor
- market balancing will be informally covered by (mainly) Saudi Arabia

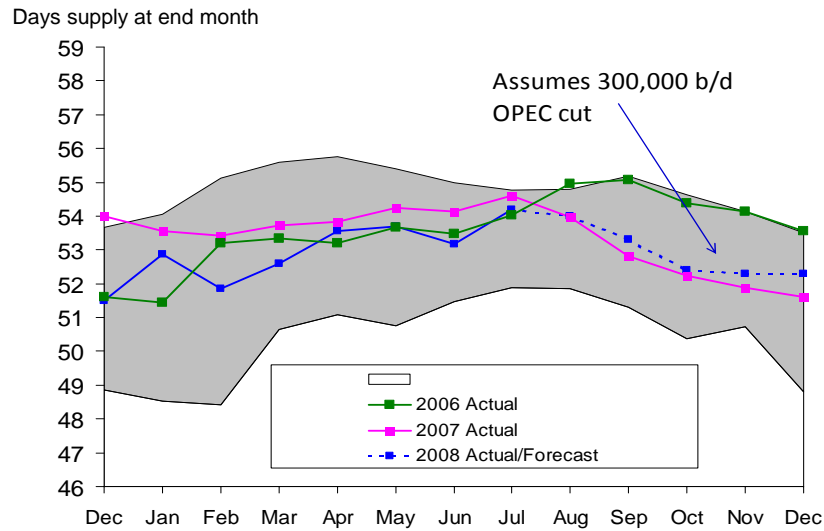
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OECD Inventories:
market is well-balanced, but a cut is needed by yr end



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Mid-Term outlook: Concern over supply constraints

- Loss of confidence in adequacy of future supplies:
 - Robust demand
 - "peak oil" theory
 - Resource nationalism
 - Lack of investment opportunities
 - IOCs no longer driving incremental oil supplies - future is NOCs
- Widespread belief in supply limit of 95-100 million b/d
- At current growth rates this would be reached by 2013-15
- This is impacting on current market sentiment

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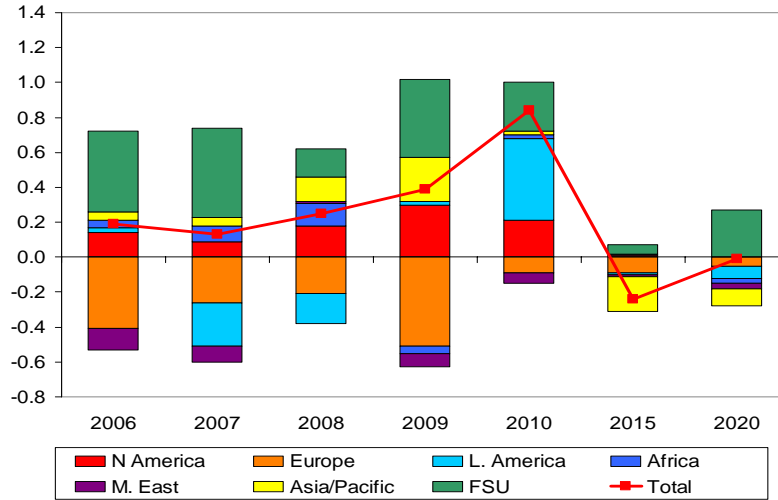
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Non-OPEC production nearing peak

mb/d change vs. year earlier



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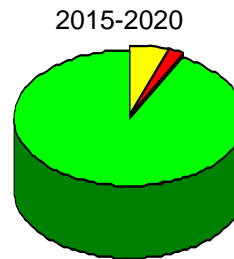
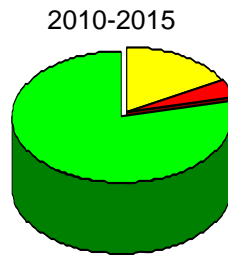
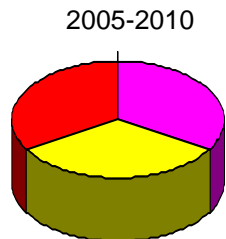
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Problem is supply constraint and concentration of incremental resources.

The inevitable increasing dependency on a few Arab Gulf producers

- Non-OPEC
- OPEC NGLs
- Other OPEC
- Arab Gulf OPEC



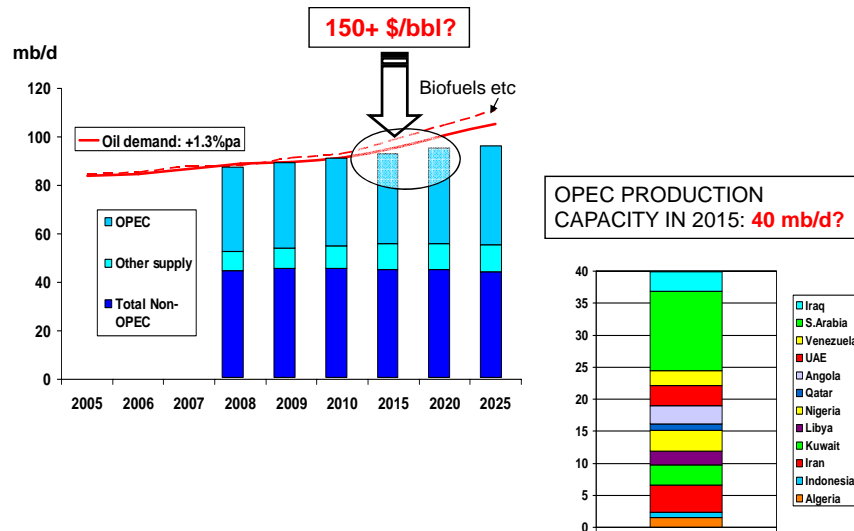
Share of World incremental oil supplies

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Why future supply concerns are justified



Conclusions

- The Oil market is going through a period of major change, being driven by a confluence of factors:
 - demand growth drivers shifting to emerging economies
 - Supply drivers shifting to NOCs from IOCs
 - reduced "market management" from OPEC
- Demand side has to be constrained – needs high oil prices
- OPEC should be able to set a floor at \$80-100/bbl but price range will remain wide and highly volatile

