



Could \$30/bbl Oil Happen Before New Year's Eve?

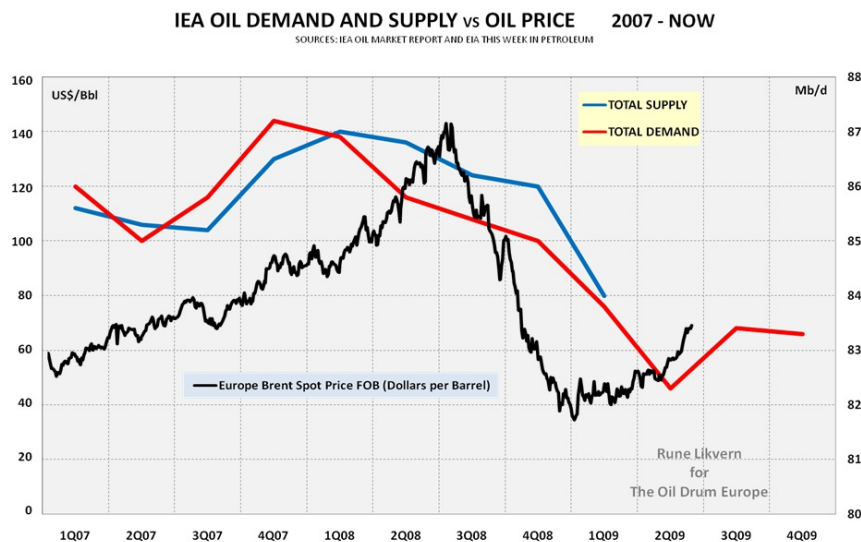
Posted by [Rune Likvern](#) on June 18, 2009 - 9:45am in [The Oil Drum: Europe](#)

Topic: [Demand/Consumption](#)

Tags: [contango](#), [iea](#), [natural gas](#), [oecd oil consumption](#), [oil prices](#), [original](#), [us oil consumption](#), [uso](#), [world oil supplies](#) [[list all tags](#)]

In [this post](#) last month, I described how the recent storage build might serve as a good proxy for describing a well supplied oil market. I also presented data suggesting that actual physical oil consumption may have been running 2 - 3 Mb/d beneath supplies.

In this post, I will present further evidence that oil markets have for some time been well supplied. Furthermore, it appears to me that both the run up last summer and the more recent run up in oil prices bear the hallmarks of an oil market now being heavily influenced by speculative forces.



The chart above shows how IEA (The International Energy Agency) have estimated total supply (blue line) and total demand (red line) in their monthly OMR's (Oil Market Reports). The diagram also shows the development of the oil price (black line).

As a result of these forces, I believe that there is a substantial chance that oil prices may again experience a rapid drop to perhaps as low as \$30 barrel before Christmas. One reason I believe this is likely is based on my research with respect to US Oil Fund [USO](#). In February USO held 100 000 WTI contracts (1 contract = 1 000 bbls), but this had dropped to 50 000 WTI contracts recently, as ETF purchasers increasingly switched to [Natural Gas](#). Strange as it may seem, the sale of these USO contracts may be part of what is holding WTI prices up, and natural gas prices down. As the number of WTI contracts reaches a minimum, this influence may turn around the other way.

DISCLAIMER: The author holds no positions in the oil/energy market that may be affected by

For those of the readers who are interested in learning more about how USO seems to operate, the articles linked below may provide some historical and fresh insights.

[A self-propelled pyramid?](#)

[United States Oil Fund, redux](#)

From alphaville, quoting Olivier Jakob at Petromatrix, dated May 12th 2009, linked above:

Early in the year, the super contango was for a big part the result of the extravagance of the United States Oil Fund ETF (USO) but their positions have been trimmed closer to the Nymex accountability level and they are now less a factor in the crude oil spread.

The managers of the USO are also running the United States Natural Gas Fund (UNG) and the recent position increases in that ETF are as troubling as what they did on WTI in the first two months of the year. Positions in the UNG have grown 4.5 times since the end of March and the positions held in the UNG could represent as much as 80% of the June Nymex NatGas Open Interest. The four day roll of the ETF starts tomorrow and to avoid the risk of being hanged by the UNG we would already move any NatGas length from June to July. The positions in the UNG are more than 7 times what would be the Nymex accountability limit, the problem is however that they holding the majority of the position in "swaps" rather than Futures.

We do not know the exact nature of those "swaps" and whether they are a swap on the Futures or a monthly pricing swap. The latter would have less of rolling impact than the former but we will assume the former for risk assessment, especially since we sincerely doubt that whoever sold those swaps to the UNG is a charitable organization.

Alphaville, in the post [The problem with commodity ETFs](#), explains the apparently strange price relationship that I mentioned in the introduction, where a sale of ETFs seems to result in a rise in prices of a commodity, and the purchase seems result in a fall in prices. This seems to be related to the fact that ETFs, because their market positions are so large, cannot hold their entire positions in commodity contracts. Instead, they hold a majority of their position on over-the-counter swaps. Changes in these positions behave differently than one would expect.

Let us continue with global oil supplies.

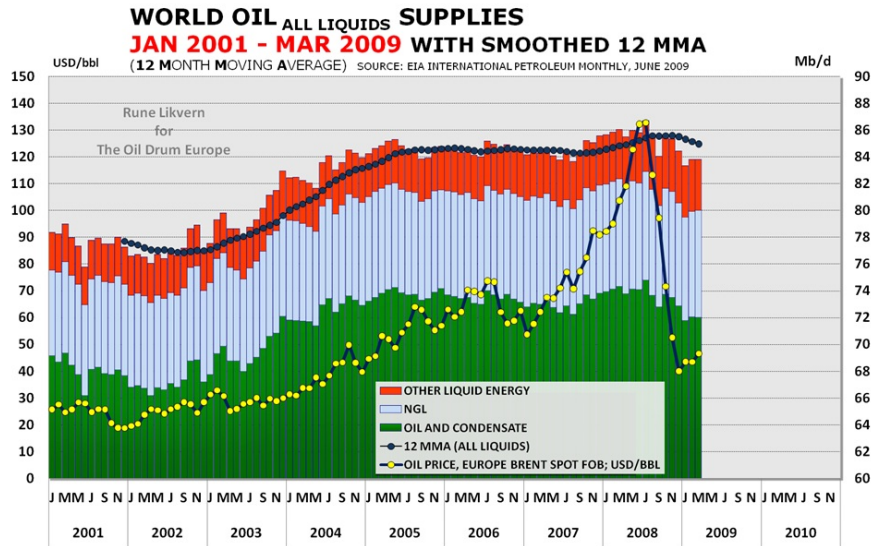


Figure 01: The diagram illustrates the world's supplies of all liquid energy (stacked columns against the right y-axis, which is not zero scaled) as presented by EIA IPM (EIA International Petroleum Monthly) for June 2009. A 12 MMA (12 Month Moving Average; black dots connected by black line) has been added to smooth the swings. Further the price development for oil (monthly averages for Brent spot) yellow dots connected by black line plotted against the left y-axis.

World total oil supplies have been running flat since 2004, and the recent OPEC quota cutbacks have not come into full effect as of March 2009. As will be illustrated with diagrams later in his post, the reduction in oil supplies has been less than the reduction in demand/consumption from OECD alone.

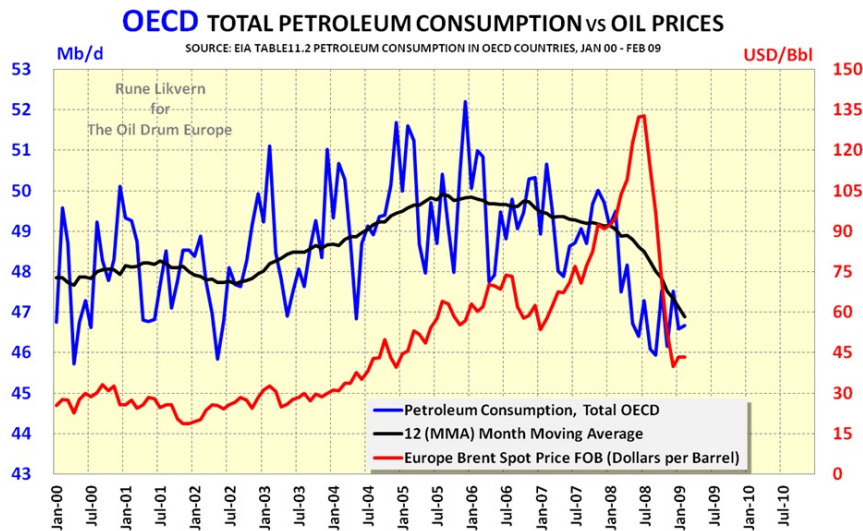


Figure 02: The diagram shows total petroleum consumption within OECD from January 2000 till February 2009 with blue lines and a 12 MMA is added (black line) to smooth the data plotted against the left y-axis, which is not zero scaled. The oil price developments are added as a red line plotted against the right y-axis.

First of all, it seems like oil consumption within the OECD area will become affected, that is consumption will stop growing and show signs of decline, as oil prices reach US\$60 - 70/Bbl and higher. This gives an indication of the OECD economies' resilience to oil price growth. Increased oil prices will at some point lead to a decline in consumption. The data suggests that OECD

From February 2008 to February 2009, oil consumption within OECD declined by approximately 2 Mb/d, which is close to the reduction in global supplies, and the decline is expected to continue, as illustrated by the diagram below.

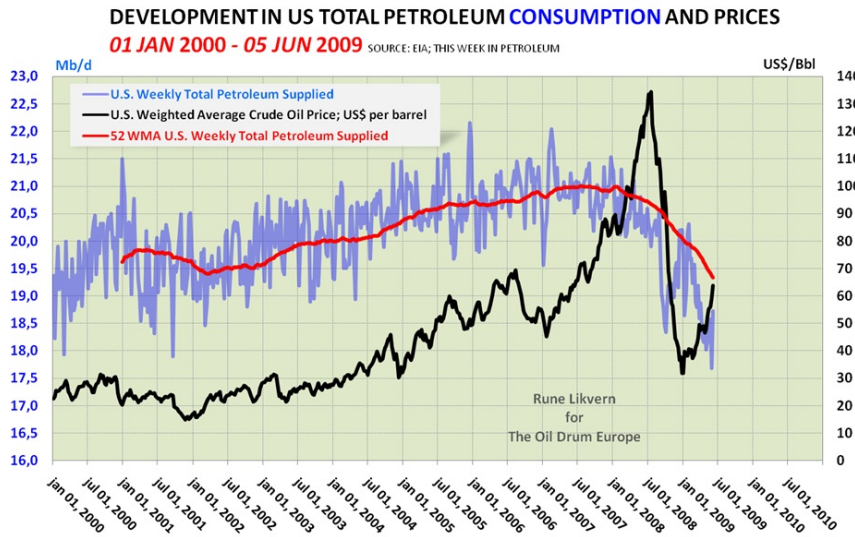


Figure 03: The diagram shows the development of US total petroleum consumption from January 2000 till early June 2009 using a blue line, and a 12 MMA is added (red line) to smooth the data plotted against the left y-axis, which is not zero scaled. The oil price developments are added as a black line plotted against the right y-axis.

The diagram also illustrates that US total petroleum consumption continues to decline.

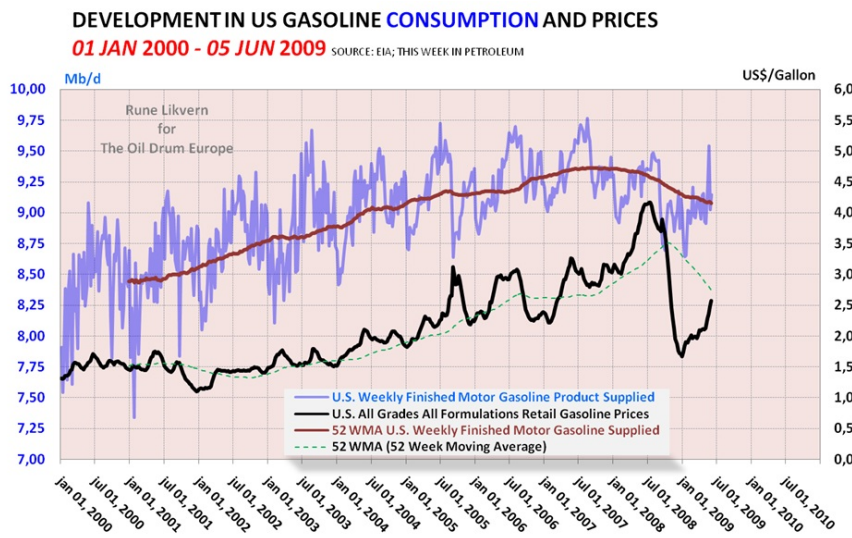


Figure 04: The diagram shows the development of US gasoline consumption US from January 2000 till early June 2009 using a blue line, and a 12 MMA is added (red line) to smooth the data plotted against the left y-axis, which is not zero scaled. The gasoline price developments are added as a black line plotted against the right y-axis.

The diagram above also illustrates that changes in consumer behavior earlier started as gasoline prices rose above US\$2,60 - 2,70/Gal. In other words, petroleum products need to be affordable for consumers. Too wild price increases will affect demand and consumers are in general in worse shape than a while ago.

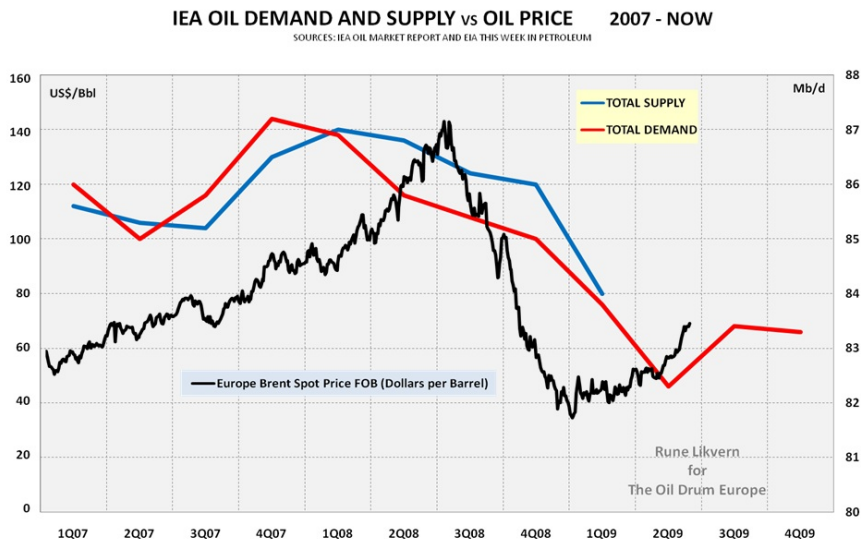


Figure 05: The chart above shows how IEA (The International Energy Agency) have estimated total supply (blue line) and total demand (red line) in their monthly OMR's (Oil Market Reports). The diagram also shows the development of the oil price (black line).

Based upon IEA's estimates it seems like the oil price growth through 2007 was mainly demand driven (demand was larger than supply). Note also the unusual steep climb in oil prices in recent weeks.

IEA's estimates also show that during all of 2008, global oil supplies were running higher than demand. If the laws of demand and supply still worked, these should not have been the cause of a growth in the oil price. Instead, it seemed like the laws of demand and supply had been suspended, and oil prices continued to defy gravity until early July 2008, when gravity again caught up with prices.

Presently it looks like some of the speculative demand (money) is shifting from oil to another related commoditynatural gas.

The above and the continued decline in consumption, higher than "normal" storage levels (within OECD), weak economies suggests an oil market that will remain "loose" for some time

What are the signs that oil prices might continue to weaken?

- Unemployment is still rising
- House prices are still declining
- Credit lines are or have been reduced
- The Dow Jones is presently down close to 4 000 points relative to this time 2008
- The dollar has lost some strength (which may explain some of the price growth)
- Many big economies are still contracting

Households' purchasing power and equities are now, in general, considerably weakened compared to last year at this time. This does not sound like an economic environment that is ready to absorb huge price rises in oil and energy.

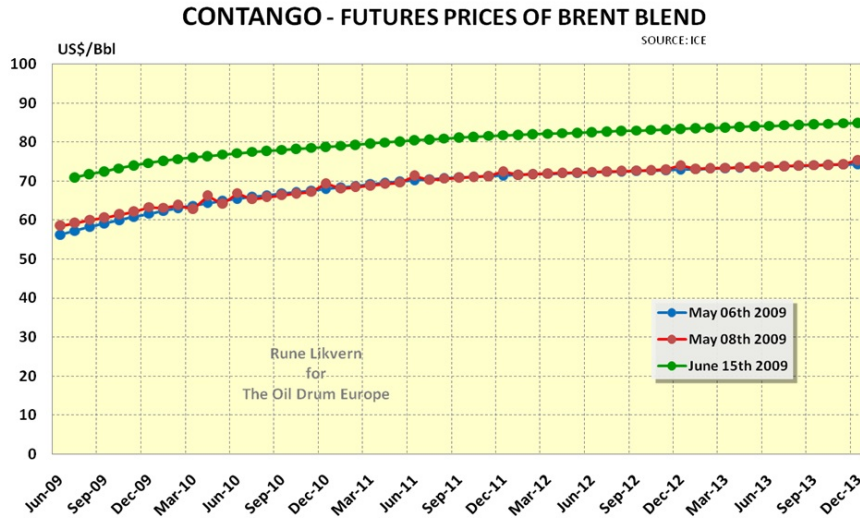


Figure 06: *The chart above shows how the present contango continues to flatten.*

Furthermore, some analysts using Elliot wave theory suggest that [Oil will fall more than 30 %](#). In addition, even the IEA thinks [speculators were part of the oil spike](#).

Because of the various issues described in this post and in previous posts, I believe that the Christmas present from the oil market may to households arrive early this year.



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