

**THE RECORD-HIGH PRICE OF ENERGY:
WILL IT USHER IN ANOTHER RECESSION ?**

As outrageous as it may sound, the US economy is faced with a situation, which could push it into recession, once again.

The catalyst, which could well push the US economy into recession, is oil, or at least, its ever-escalating price on world markets.

If the US falls to the evils of economic recession, so will many other economies of the world.

How much higher the price of crude oil will go is anybody's guess, considering the state of the world, but somewhere between \$US50 per barrel and \$US60 per barrel is the current estimate, which could start the ball rolling, sending the US economy onto the first leg of recession, as it starts to wobble, vigorously.

At more than \$US60 per barrel of light sweet crude oil, it could well cause the US economy to crash, as the weight of the cost of energy takes its toll on the largest powerhouse the world has ever seen.

As at yesterday's price of light sweet crude oil — \$US43.82 per barrel for September delivery on The New York Mercantile Exchange (NYMEX) – considering that international terrorism is not abating, contrary to previous predictions by the US State Department, the price premium for crude oil to take into account for the risk of international terrorism is, at the lower end of the scale, \$US5 per barrel, rising to \$US10 per barrel in the top end of the scale.

Since it is a well-worn, proven axiom that trend is an investor's friend, oil speculators will jump in, boots and all, as the price of crude oil continues to rise, for whatever reason(s) ... and it will continue to rise.

Speculation will beget speculation, without question.

The appearance will be, most likely, that high oil prices are here to stay.

And that appearance might, possibly, prove to be true.

That, having been established, consumers, worldwide, are more than likely to rein in spending, quite substantially, and many an industrialist will look to diversify into other fields, away from productivity, dependant as it is on energy, in an effort to try to enjoy the fruits of Information Technology and other endeavours, which are not as dependant on energy as are manufacturers of steel, aluminium, plastics, paper, chemicals, and etc.

Businesses, worldwide, are very vulnerable to higher energy costs; and, the ill effects of any substantial increase in a fuel bill of a business cannot, always, be passed down the line to consumers.

Many manufacturers and nearly all transportation companies, especially, are not always able to stick it to their customers because, by so doing, it could impact on them in very short order, as consumers cut back on spending because real incomes will be subject to rapid erosion, proportional to the cost of energy.

The higher goes the price of energy, the greater impact it will have at the family unit level.

This, clearly, translates into lower levels of consumer spending.

The situation could be likened to a government, imposing higher taxes on its population.

Whereas a government's income from the imposition of taxes on its population is supposed to be ear-marked for infrastructural projects, the delivery of social systems, such as medical services, the establishment of schools, the creation of parks, etc, higher energy bills only go into the pockets of energy producers, many of whom, as the world knows, only too well, are Arabs and Africans.

From the point of view of the US Government, in its present, rather precarious position, with the price of crude oil, starting its run to the \$US50 per barrel mark, higher energy prices will benefit the country not one iota.

It has been estimated that the lion's share of President George W. Bush's much-vaunted, tax-relief programme will, just about, pay for the increases in the price of petrol at the pumps of Mr and Mrs America, as well as paying for the increased costs of heating fuel.

That amount of money is some \$US50 billion, by the way, most of which will be released into the US economy, this year.

Lower-income households of the US will feel the impact of higher energy costs the most since a large proportion of their earnings are paid out for heating, electricity and petrol.

It is a well-established fact, too, that a household, with a total annual income of \$US50,000, spends about 8 percent of that amount of money on energy, in one form or another, directly or indirectly.

Above that \$US50,000 threshold, the budgetary expenditure on energy starts to taper off.

The Causes Of Increased Prices

From January to August 2, this year, the price of a barrel of light sweet crude oil on The NYMEX has risen from about \$US30 to yesterday's price of about \$US43.82.

That is an increase of about 46.07 percent.

Such an increase over such a relatively short period of time is inflationary, to say the least.

At the petrol pumps of the US, this increase in the price of crude oil has translated into the consumer's onerous burden of a hike of the order of about 33 percent – from about \$US1.50 per gallon of regular unleaded petrol to about \$US2.00-plus per gallon.

The ever-rising incidences of international, terroristic acts on the indigenous population of Iraq, as well as attacks on oil installations and pipelines in the country, and similar acts of sabotage in Saudi Arabia, are weighing heavily on the oil markets of the world, with speculation, being rife, that these matters will not go away in a hurry.

And, then, just last Sunday, the US Government announced a very credible danger of Islamic fundamentalists, attacking the US homeland, at New York and Washington D.C.

In the first half of this year, to June 30, US refineries were said to be operating at record levels in their attempts to try to meet the demands in the US for petrol and distillate fuels.

According to The American Petroleum Institute (API), US-based refineries were operating at about 92 percent of capacity.

This was their highest levels for any 6-month period in the previous 3 years.

The statistics of The API stated that petrol production rose by about 3 percent to nearly 8.60 million barrels per day, during that period.

Distillate production increased more than one percent, in excess of 3.70 million barrels per day.

The demand for US-produced petrol waned, during that period of time, as prices at the pumps rose, along with retail prices for goods: The higher costs of running the family motor car had taken its toll.

While the demand for petrol abated in the first half of this year, the demand for residual fuels, jet fuels and distillates, remained very strong, according to the statistics of The API.

During the first quarter of this year, the US economy was powering along, causing the demand for petrol to rise by about 3 percent.

But that situation has, now, been relegated to history.

As Americans determined to travel more and more by air, so the increasing demand for air travel resulted in the price of jet fuel to hit the largest, year-to-year increase in many a moon.

As a result of the improvements in the US economy, during the second quarter of 2004, deliveries of distillate fuel oil rose more than 6 percent: Diesel fuel for the trucking industry and diesel fuel for other uses was in strong demand.

Looking at the supply side, during the first half of 2004, both petrol and distillate inventories, as at June 30, were about 5 percent below average.

As for crude oil stocks, they stood at about average levels, at about 305.40 million barrels.

During the first half of this year, petroleum imports of crude oil and oil products accounted for about 62.30 percent of the total consumption in the US.

Which tends to underline how dependant is the US on such imports.

The US is, after all, the largest single consumer of energy in the world.

More recently, there have been problems at oil refineries in Germany, the Netherlands, Turkey, South Korea and Japan.

Fires and shutdowns at oil refineries are temporary situations, of course, but, coupled with other international problems, besetting the oil industry, they tend to exacerbate an already difficult supply condition.

An example of the above was the closure of Japan's biggest oil refinery, Nippon Oil Corporation, which stopped operation on Sunday, July 25, at the time of one of the country's biggest heat waves.

Another example: In South Korea, the strike at LG-Caltex Oil Corporation has been ongoing for the past 17 days.

YUKOS And You

And, then, there is Russian oil giant, OAO Yukos Oil Company, known more familiarly as, simply, YUKOS.

Last Wednesday, the Russian Justice Ministry Ordered YUKOS to stop the production and exportation of crude oil from the country.

The Justice Ministry reversed that Order, one day later, stating that there had been a misinterpretation of its Order, which only meant to apply to other assets of YUKOS, not the production of sales of crude oil.

Exports of crude oil from YUKOS represents about 2 percent of the world's total production.

If exports of oil from YUKOS were to stop for any appreciable time, it, most likely, would propel the price of crude oil past the \$US50 per barrel level.

And the US economy would, most likely, not be able to withstand such a price increase.

Many other countries, also, would be hit hard by any long-term stoppage of oil exports from YUKOS, with the People's Republic of China (PRC), being on top of the list of countries to balk.

This is because YUKOS is, today, exporting about 55 million barrels of oil to the PRC, annually. This oil is transported by rail.

Other Eastern European countries would, also, get hurt if YUKOS were to halt oil exports.

The PRC, naturally, would be forced to find alternate sources of crude oil should the Russian Government cut off the supply of YUKOS's oil to the most populous country in the world, today.

The PRC, with its booming economy, is thirsty for crude oil, but, if it is forced to look elsewhere for another 55 million barrels of crude oil per year, it will stoke up the inflationary fires, further, both domestically and internationally.

This will have a knock-on effect, internationally, as the increased cost of energy in the PRC would be passed, down the line.

According to official figures, released by the Government of the PRC, the total electric energy output in the PRC between January 1, 2004, and March 31, 2004, rose by about 18.10 percent, Year-on-Year, to 1.16 trillion kilowatts.

Hydro-electric stations, which came on stream in the PRC, during the first quarter of 2004, contributed about 176.04 billion kilowatts to the power supply.

That is an increase of about 30.90 percent, Year-on-Year.

Thermal power plants generated 955.90 billion kilowatts of power, during that period. That amount of power represented a gain, Year-on-Year, of about 16.44 percent.

As for the PRC's nuclear power stations, they raised output to about 25 billion kilowatts, representing an increase of about 19.40 percent, Year-on-Year.

The above statistics suggest, conclusively, that the requirements of the PRC for energy is growing at a very rapid rate as its economy continues to boom, supplying many parts of the world with its products.

In the first quarter of this year, the PRC's Gross Domestic Product grew by about 9.60 percent, Year-on-Year.

If the PRC is forced to raise the export prices of its goods, due to the burdensome, higher costs of energy, the US economy will feel the heat, immediately.

Exports of PRC-manufactured goods, destined for The Land of The Free and The Home of The Brave, at higher FOB (Free On Board) prices will mean increased costs to the US consumer, who is, already, reeling from the increased costs of energy, at home.

It is an historical fact that increased energy costs are a precursor to undermining an economy's expansion.

Since World War II (1945), every economic recession has been preceded, if not precipitated by, increases in energy prices.

Lighting homes, running air-conditioners in the summer, and operating heaters in the winter, as well as operating motor vehicles, all consume copious quantities of energy.

Higher energy costs impact dramatically on consumers and contribute to inflationary pressures, tremendously.

It is estimated that for every penny increase in the price of a gallon of petrol in the US, it costs consumers about \$US1 billion per year after the increase.

Since January 1, 2004, annualised consumer spending in the US on energy and energy related products and services has increased by about \$US50 billion, to about \$US450 billion.

When the US economy suffers any appreciable downturn, it impacts very negatively on other economies of the world, sending some of them, spiralling into deflation, cascading into recession.

The negative consequences of higher energy bills cannot be ignored because, aside from being terribly inflationary, they impact, most dramatically, on the poorer nations of the world, many of which are forced to purchase goods and services from economies, which are more developed than theirs.

The US paid about \$US125 billion for its imports of crude oil in 2003. That was the time that crude oil prices averaged \$US30 per barrel.

For 2004, one may expect the bill for crude oil to be somewhere in the region of \$US200 billion.

This will impact on the Gross Domestic Product of the US, probably shaving off about 50 basis points.

This has, in fact, already been felt, as industrial production in the US has been seen to have faltered, following constrained consumer spending, relative to the rate of spending, earlier this year.

While the US Presidential Election campaign has tended to obscure the current precarious situation in respect of energy costs – and it would not be useful for President George W. Bush to acknowledge the potentially dangerous situation to the US economy due to higher oil prices – the possibility is, now, only too apparent that, unless immediate action is taken to rein in the higher prices of energy, the industrialised world could be held to ransom.

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