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THE FUTURE OF CRUDE-OIL PRICES IN 2010: WATCH OUT FOR $US147 PER BARREL – AGAIN !

Eventually, the financial stimulus packages, of the United States of America, of Europe, of Asia, of the Antipodes and of the Middle East will have to be unwound.

Various governmental agencies of a multitude of nations will have to consider ways and means to control the inflationary pressures that are certain to have been innately caused by the requirement of the emergency financial measures of the past year or so.

For the time being, of course, there is no reason to activate any plans that may be on the drawing boards of various countries in order to rein in the many tens of billions of US dollars/sterling pounds/euros, etc, etc, etc.

In fact, to rein in, today, the tens of billions of US dollars/sterling pounds/ euros, etc, used in the stimulus packages in order to kick start the economies may well cause a recurrence of the problems that required them to be put in place, in the first place.

A major problem that is likely to manifest itself at the tail end of this year and during the first half of 2010 may well be that, at about the same time that various different governmental agencies of a variety of countries will be trying to tackle the problems of curtailing what they perceive as nascent inflation, the price of crude oil will be seen to be rising, steadily – adding to the prospects of widespread inflation, internationally.

In fact, it is almost an odds-on favourite that, by this time, next year, the price of crude oil will be approaching $US147 per barrel – if it does not rise to that level, earlier.

As the price of crude oil continues to rise toward the record level of July 11, 2008, so the effects of its rise will be felt, from the cost of operating the family motor car, to the cost of international travel, to the cost of producing plastics, to the cost of the baby's diapers, etc, etc, etc.

The above scenario appears to be inevitable.

The following is **TARGET**'s reasoning:

The Fundamentalist v. The Bubble Concept

This year, the price of crude oil has already risen from about $US40 per barrel to the current level of about $US70-plus per barrel.

In January 2008, the price of a barrel of crude oil was about $US90-plus per barrel.

And the price rose to about $US147 per barrel within a period of about 6 months.

By December 2008, the price had collapsed back to below $US40 per barrel.

One of the most-popular reasons for the record, crude-oil level of $US147 per barrel was the suggestion that the world was about to run out of the black ooze.

It was a popular belief, made by a number of experts from many parts of the world, that supply-demand factors were at work; and, that was the prime reason for the price of this strategic commodity to hit the record-high level of $US147 per barrel.

Even the US Treasury got into the act, confirming and attesting to the popular belief.

Of course, it was all bunkum.

But it sounded plausible, at the time.

The nodders assented, willingly.

Then, there were those experts who extolled the virtues of the so-called bubble theory.

This theory went along the lines that the price of crude oil had risen because of widespread speculation and momentum trading practices (whatever that is supposed to mean).

According to **TARGET**'s belief, momentum trading is akin to a motor car, picking up speed as it goes down a steep grade, with the driver, being unable to stop it due to a faulty braking system.

The vehicle will continue to accelerate, according to its weight and design, as it careens down the grade, making it more and more difficult to stop.

But there is a limit to the speed to which the vehicle can achieve.

The oil price, the bubble theory went, was when the price went beyond the long-term equilibrium level, determined by fundamentals.

Looking at the *'logic'* behind the suggestion in 2008, that the world could be running out of oil, well, Saudi Arabia, the world's largest, single exporter of oil, representing about 25 percent of known oil reserves, was said to be in dire straits and that the country would be unable to maintain a production level of about 9.50 million barrels of crude oil per day.

The figure of 9.50 million barrels per day production level was what the country was exporting in 2003, however.

In 2008, Saudi Arabia had a production capacity of about 11.50 million barrels of crude oil per day.

For the current year, the country is planning even higher production capacity levels.

The year 2009 is likely to see Saudi Arabia increase crude-oil production beyond 12 million barrels per day.

So much for that theory.

As for the fact that the price of crude oil had dropped like a stone, thrown into a deep well after it hit $US147, that was said to have been due to suggestions that there had been further discoveries of commercial oil and that reserves could well be far above previous estimates for such reserves.

But nobody ever came up with the facts.

This was because there were no such discoveries.

So much for that belief.

Turning to the fundamentalist theory, which states that there are other considerations, other than just supply-demand factors, it went along the lines that there is, always, a lag factor between the facts and price responsiveness.

As this medium has stated, on many occasions, when a market is in a bullish mood, the slightest positive piece of news tends to send prices rising, materially.

Conversely, when a market is in a bearish mood, some of the most exciting bullish news is often discounted with generalisations and rationalisations, being used to pooh-pooh it.
The Gross Domestic Product of the world in the first half of 2008 was about equal to the like period in 2007.

As such, one would have expected the price of crude oil to rise in line with demand.

However, in fact, the demand for crude oil actually fell to about 86.30 million barrels per day in the first half of 2008, down from about 86.50 million barrels per day, compared with the second half of 2007.

Meanwhile, the production of crude oil rose, during that period, by about 1.17 percent, from 85.80 million barrels per day to 86.80 million barrels per day.

As such, one would have expected oil prices to have fallen in the first half of 2008.

But that did not transpire, also.

Therefore, fundamentals are not everything when it comes to explaining the reason for rising prices of commodities.

The lag time between price responsiveness and the knowledge of the facts is, always, a popular belief, but it is not, always, a reason for a price rise or a price fall.

It is an historical fact that, at times of recession, more often than not, the price of crude oil remains firm.

This is not to suggest that that will always be so because, as in the case of a chameleon, crawling over a tartan rug, its colour changing with the colours of the rug, so, in the case of recessions, no 2 recessions are identical, with a number of factors, varying, depending on the root causes for the economies to fall into recession.

Speculation and Price Manipulation

In the US, today, it is thought that widespread speculation on oil futures contracts, as well as attempts to manipulate market prices, were among the root causes for the fast rises and falls in price of crude oil on international commodity exchanges.

Various US Government agencies are keen to improve the quality and transparency of data as it applies to futures contracts for commodities.

The reason for this move toward more transparency is confirmation that as much as 20 percent of the traders in crude oil on The **N**ew **Y**ork **M**ercantile **Ex**change (**NYMEX**) are, in fact, commercial traders – speculators, if you will.

These commercial traders take positions as to the likely direction of the price of crude oil and they purchase futures contracts, thus driving up, or pulling down, the price of the strategic commodity.

What would be the optimum to be achieved, if it can be achieved, at all, is that net NYMEX positions would not obscure the true relationship between the positions, taken by players in the futures' markets, and spot-oil positions.

In other words, to differentiate, isolate and identify the speculators from the hedgers and the spot buyers.

In that manner, one may be able to relate spot prices to long and short futures' positions and be able to interpolate and extrapolate from the data.

There have been suggestions, also, that it may be advisable to impose trading limits on contracts for select energy products.

But these suggestions have been on the cards since 2006 when the US Senate Permanent Sub-Committee first toyed with the idea.

Limits have, for many years, been placed on certain US agricultural products, such as corn, wheat, etc.

If price limits were to be placed on material, erratic movements of crude oil futures, it would mean that the Management of NYMEX would lose control of part of its market – which is the largest commodity market of the world, by the way – since, in the past, management of NYMEX has set its own limits.

Recently, President Nicolas Sarkozy of France has commented on what he called, *'damaging speculation'* on oil futures.

It is accepted that momentum trading has been driving prices up or down of late, but its effects are, usually, short-lived as reality takes over from speculation.

A bubble situation is achieved when spot prices for crude oil are significantly higher than the equilibrium price.

The equilibrium price is determined according to fundamentals, supply-demand factors, being but one consideration.

Recently, the equilibrium price for crude oil has been set at between $US70 per barrel and $US75 per barrel.

That price was set by the President of the United Arab Emirates, Sheikh Khalifa bin Zayed Al Nahyan, and the Minister of Petroleum for Saudi Arabia, Mr Ali Al-Naimi.

At this price range, it was stated that it was fair for both producers and consumers.

Of course, the members of The **O**rganisation of **P**etroleum **E**xporting **C**ountries (**OPEC**) would not make a move to stop the price of crude oil, rising toward, or beyond, the $US147 per-barrel level.

Allah is Great!

Love that Money!

Conclusion: It is very obvious that there is going to be an increase in the price of crude oil in the coming months.

The climb to higher levels has, already, started, in fact.

As the world emerges from recession, the demand for crude oil will rise in line with the rate of recovery in the growth of the economies of the US and eurozone.

This will cascade down to Asian suppliers, which will speed up production in order to keep up with the increased demand from their largest customers.

As crude-oil inventory levels drop, so the price of crude oil is quite likely to rise.

There will, undoubtedly, be speculation on oil futures and no amount of interference in market forces will be able to prevent it.

It is noted that there have been postponements in planned exploration for new oil fields and the expansion of existing, commercial fields.

The idea that new technologies could reduce the world's dependence on fossil fuels in the next few years is hogwash.

Over the next few years, demand for crude oil will continue to rise.

That is, almost, a given.

If the supply of crude oil does not match demand, then, another crisis could loom on the horizon.

In short, speculation will drive up the price on oil-futures contracts, way above the so-called equilibrium level.

Industries, that are forced to hedge on commodity exchanges for crude-oil supplies, will have to compete with the speculators who are pushing prices up to higher and higher levels.

Spot prices will rise in tandem with the prices of crude-oil futures; and, inflation will become a recurrent theme of discussions at such agencies as the US Federal Reserve, an interdependent entity of the US Government whose mandate includes keeping the lid on inflation.

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