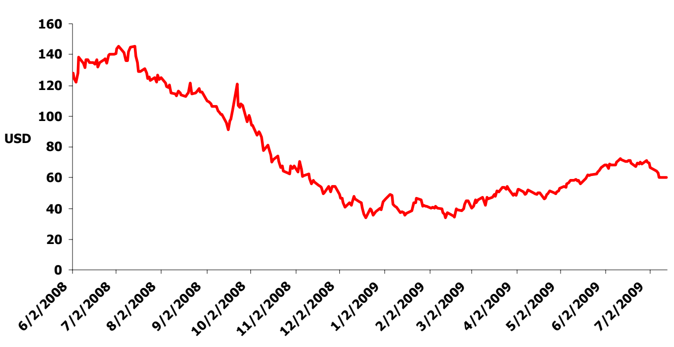
Crude Oil: Swinging at an equilibrium?

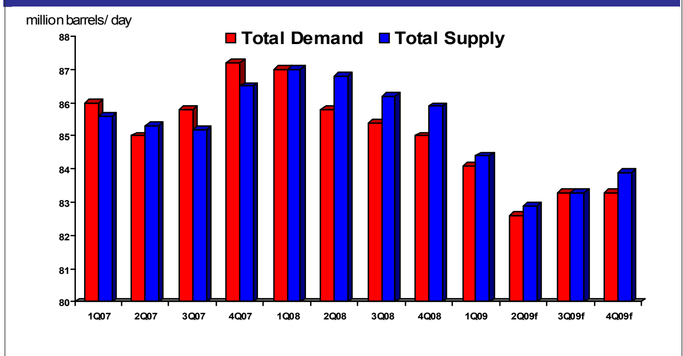
14 JULY 2009
2009/0001

Oil price lost 18% since 2009 high of USD$73.3 in June...



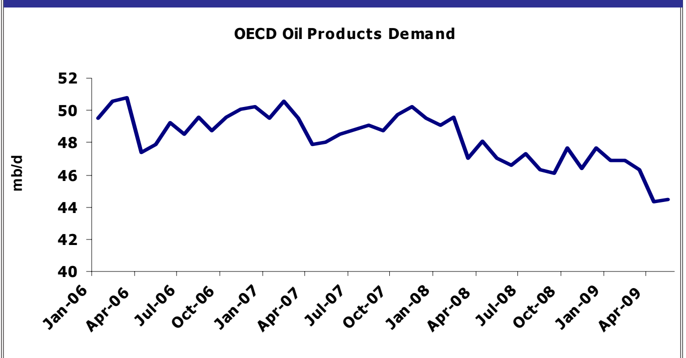
Source : Bloomberg

Matching in demand and supply for the 2H09...



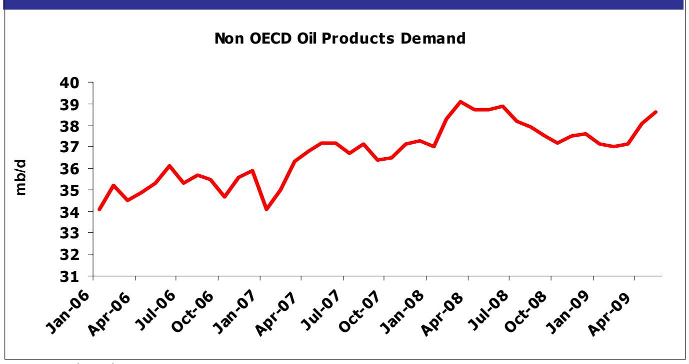
Source : EIA

Lower demand from developed nations...



Source : Bloomberg

...But rising on the other side of the world...



Source : Bloomberg

- **The President of the Organization of the Petroleum Exporting Countries (OPEC) announced that a stable price for crude oil this year would be in the range of USD68 to USD71.** Though it is below the expected price for producers, they are tolerant on the hopes of an economic recovery which will be beneficial for them as well. Rising oil prices would just stifle economic recovery and spur inflation.

- **Oil prices soared to USD147 a barrel last year July on the New York Mercantile Exchange (NYMEX) before crashing down to just USD45 a barrel on December the same year.** Now, it hovers around USD60. The positive sentiments in global recovery and the weaker dollar aided the price surge.

- Last year, governments faced policy challenges to decrease inflation which rose to 5.1%, seeking to correct the spike in oil price. On the other hand, this year, inflation is no more the area of contention as governments seek to boost growth.

- Though there are sentiments of positive recovery in the near term, a pickup in economic performance or business confidence, the rally in oil prices since March was not justified by the weak global crude demand.

- **Last year's oil rally blamed the producers in the Middle East for keeping supplies down, but now the "depressed" in oil prices is attributed to the financial crisis.**

- **Highlight is now on the speculators and traders for creating the uncertainty in prices.** But, the basis of their trade is on the expectations of demand rising in tandem on the outlook that global economy will recover by the end of the year, with special regards to the emerging economies. Global demand now maintains low but with increase in supply and higher inventory growth.

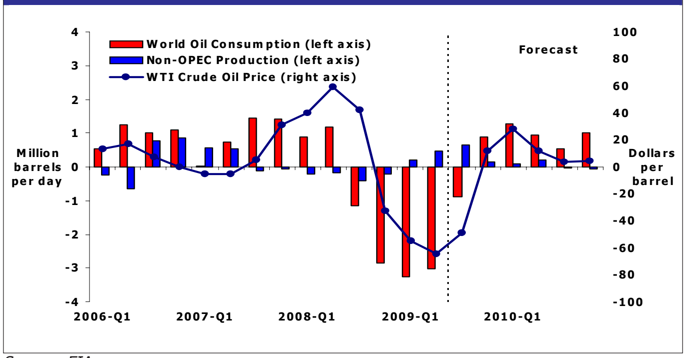
- **The International Energy Agency (IEA) forecasted a 1.7% rebound in demand or +1.4 mb/d to 85.2 mb/d, largely led by non- OECD countries by end of 2009.** Though overall demand for this year is forecasted lower at -2.9% compared to a -0.3% decline last year.

- **OPEC announced oil field investments have been cut to about a third as the economic crisis and initiatives towards increasing fuel efficiency led to a big cut in projected demand.** OPEC has revised its oil investment outlook downwards reflecting such the conditions.

- **OPEC revised investments for exploration and production to USD110 billion to USD120 billion from 2009 till 2013 as opposed to the previous USD165 billion.**

- It is also to be noted that, with the cut back in exploration and drilling activities, revised investments should be able to take in demand capacity coming in from Asian countries.

Consumption expected to pick up only by next year...



Source : EIA

- The correction in the oil prices only reflects the current situation of stock draw coupled with energy efficient laws undertaken by the US and Europe and also the proposal in the tightening of trading regulations by the Commodities Futures Trading Commission (CFTC).

- **We believe that the 2H should reflect true demand levels as OPEC has cut on investments, intensified with falling consumer sentiments and employment levels in the United States and other major developed economies.** Company earnings of large corporations should also be looked into to gauge the state of global recovery to verify the anticipated climb in demand for 2010.

- **On that note, the forecasted price by end of 2009 is expected to hover in the USD70 to USD80**, (EIA:USD70 to USD74) demand is anticipated to moderate by then, matching stockdraw in supply.

- **Whereas for the 2010 outlook, we believe, oil prices should pick up with the anticipated climb in demand to USD72 to USD85.** Given the greater enforcement of the CFTC and the green initiatives this will still level down the demand from the OECD countries. The lower investments will in turn restrict growing supply to match with rising demand and hence push prices up.

- With that in view, this will bring comfort for the Malaysian government as it will benefit from higher oil prices in lessening fiscal deficit, due to huge fiscal stimulus spending.