NOESIS™

Forecasts Archive

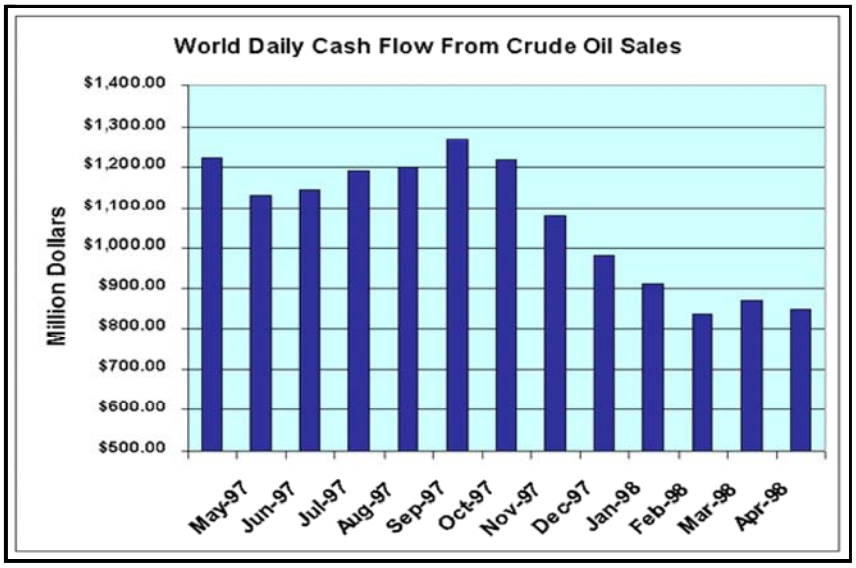
Go Back to:
Imports Summary | Other Archives | Current Forecast

September 21, 1998

Crude Oil and the World's Cash Flow Problem

Missing 81 Billion Dollars

From the "oil-patch" perspective, the current world financial problems can be related, in part, to the fall in the price of oil - a catalyst, or as we say in the U.S. "the straw that broke the camel's back." Over the past 9 months, industrialized countries collectively saved an estimated 81 billion dollars. That's 81 billion dollars that did not flow to producing countries and oil companies. No doubt many emerging nations that find themselves in financial trouble this year were extended credit based on their forecasts for crude oil production and sales. No one anticipated that a mere 3% increase in the world's crude oil production would result in a 32% reduction in world-wide cash flow.

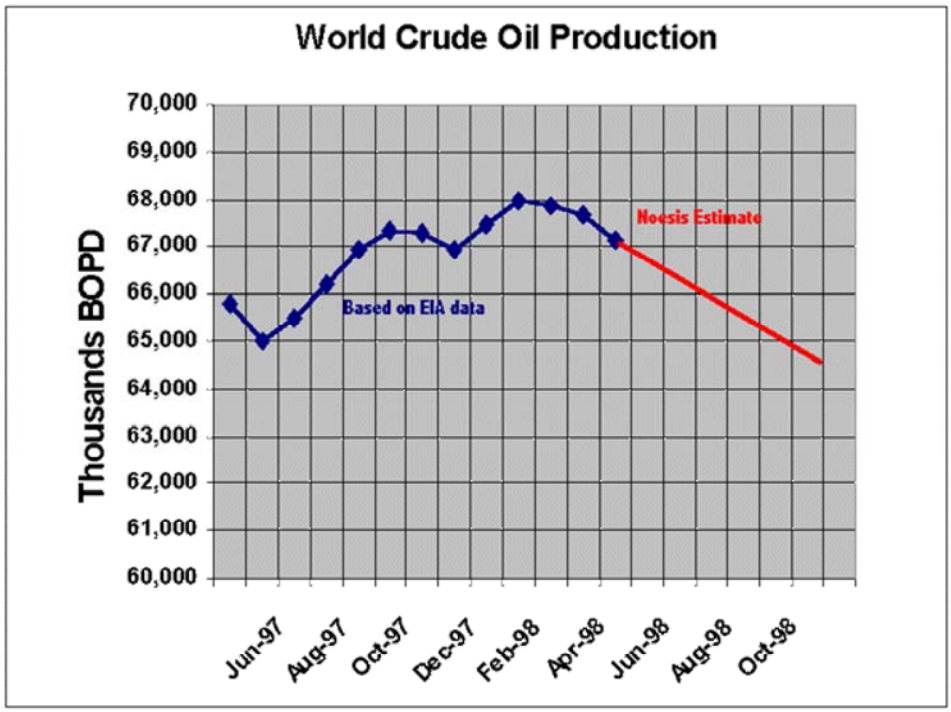


Oil is Not Gold

Relying on oil to secure credit doesn't work as well as gold (or other solid, tangible

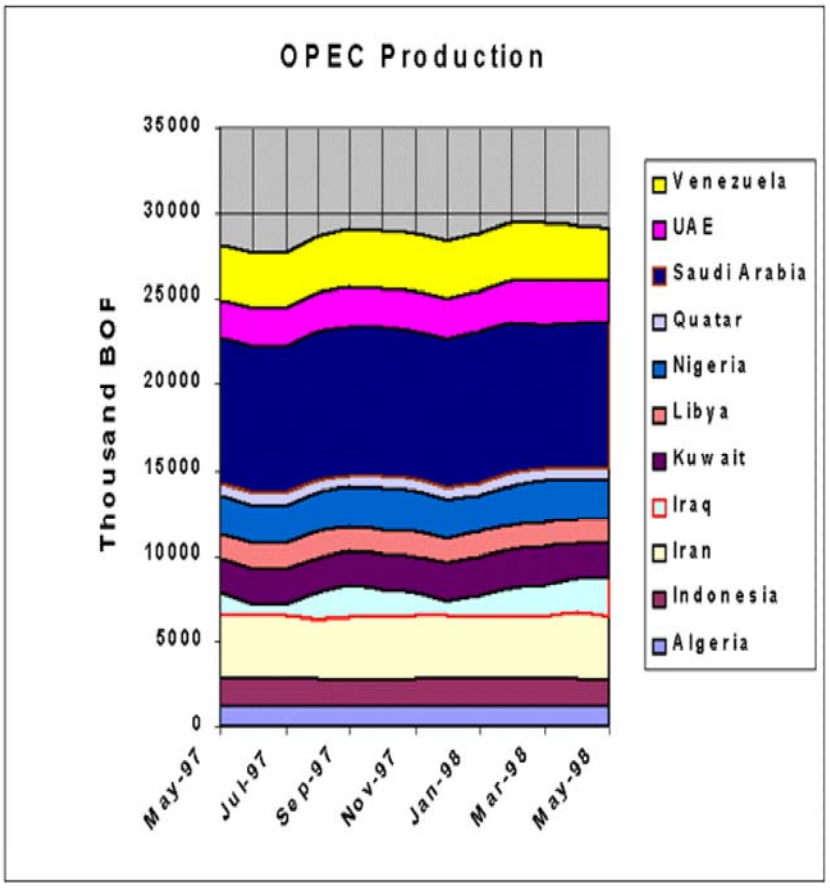
items). Think of the problem in terms of storage. An ounce of gold is worth roughly $290.00. An ounce of gold is tiny and anyone can purchase it. You could put many ounces -- even pounds of gold in a small safe. When a lender calls a debt due, he can take possession of the gold. On the other hand, the equivalent of one ounce of gold in oil at $12/barrel is 24 barrels. At 42 gallons per barrel, that would be 1,008 gallons of crude oil. Try storing 1,008 gallons of crude oil in a safe. . .

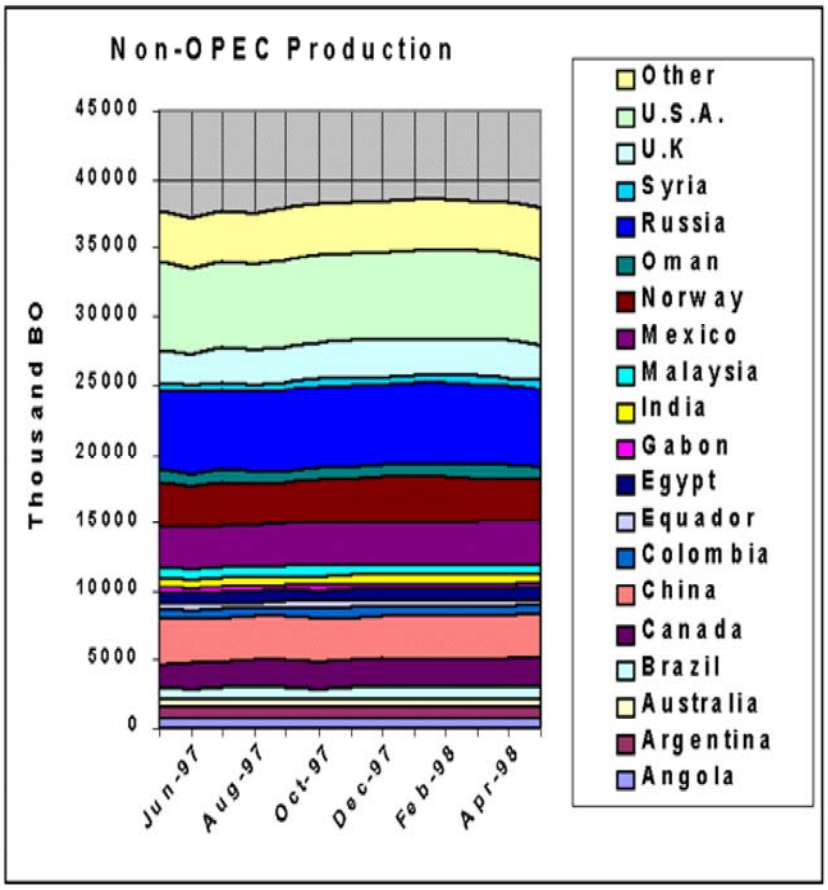
Logistically, the best way to store huge amounts of crude oil is to leave it in the ground where we refer to it as "reserves." The problem is that as long as the oil is in the ground, no one knows exactly how much of it there is. Petroleum Engineers around the world spend long hours diligently calculating and recalculating reserves. Because reserves are still in the ground, the value of the reserves is based on the cost of production, i.e. if you cannot produce the oil for the market value or better, then you theoretically don't have any reserves. Thus, reserves are generally calculated as "that oil which can be produced at the current market value of crude oil." You should know this tidbit because if the price of crude oil remains low past January 1, 1999, next year's estimate of reserves will be significantly lower than this year's estimate. Not that there is any less oil in the world -- it's just not available at the current price.



[See the table of data by Country]

Production swelled on all fronts in 1997. The following pictures show crude oil production by OPEC and NON-OPEC countries. The units are in Thousands of Barrels of Production per Day (BOPD).


OPEC Production
Thousand BOF
35000
30000
25000
20000
15000
10000
5000
0
May-97
Jul-97
Sep-97
Nov-97
Jan-98
Mar-98
May-98
Venezuela
UAE
Saudi Arabia
Quatar
Nigeria
Libya
Kuwait
Iraq
Iran
Indonesia
Algeria



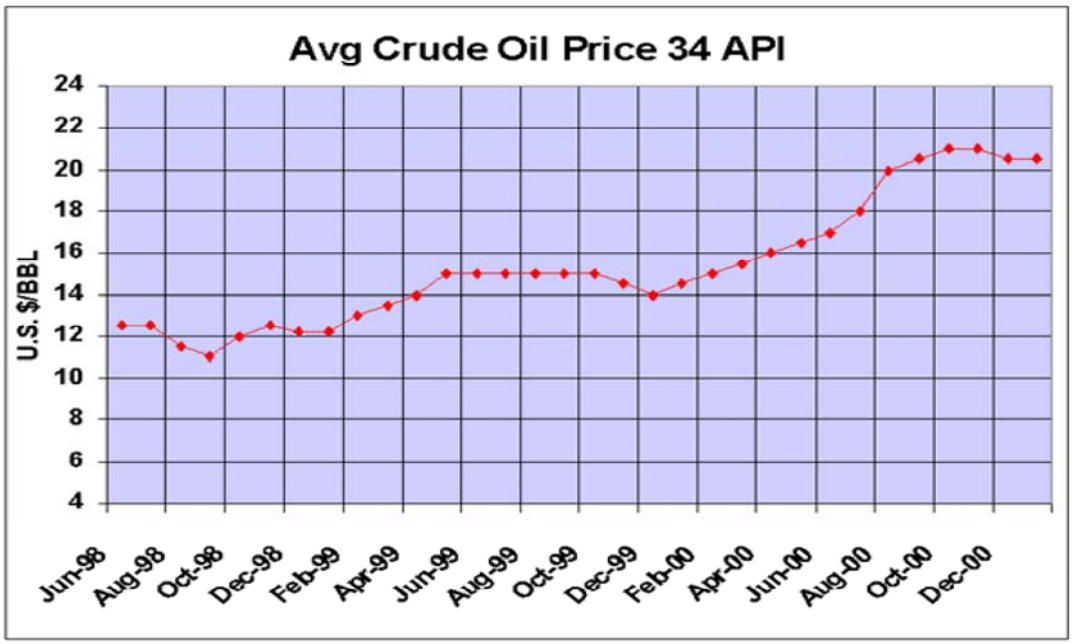
Once oil is produced it is quantifiable. It is also a nightmare to handle. Ideally, you produce it, put it on a tanker, and deliver it to a refinery where it is refined into products which are sold and almost immediately consumed. The system is very delicately balanced. While there are a few facilities around the world that store crude oil (wide spots in the transportation system), there is no storage space to allow accumulation of oil over time. When the system gets out of balance as it did this year, low demand coupled with high production results in excess oil with no place to go. The result is chaos -- and low crude oil prices. This situation would never happen with gold. While gold "reserves" surely depend on production costs, once gold is produced it can be stored and saved to control the market value. Gold also does not disappear, whereas oil is a once-through product. Once it is refined and sold, it is consumed and gone. Although gold is used in some manufacturing, it can also be recycled -- traded over and over again, so it has lasting, and accumulating, value to the world.

So, although oil has often been referred to as Black Gold, it has some significant limitations that should be considered as the world deals with rapid industrialization in emerging economies. Remember, the U.S. economy, which works so well now, was originally developed on a gold standard, not oil.

<u>Getting Better</u>
If production is on the path projected, the world should be nearing balance -- although additional factors must now be considered. For instance, as a result of the lack of cash flow and subsequent credit problems, economies slowed down and demand for oil decreased in many countries, therefore production actually must be reduced to levels below former production rates to balance supply with demand. Once economies become reestablished, demand should rise, and so should the price of crude oil. Right now, it looks like the world economy is on the path to

recovery. Success depends on how well disciplined producers will be in managing crude oil production.

The NOESIS forecast shows recovery of crude oil prices in 1999, assuming producing nations continue to hold crude oil production down. By next year, the U.S. will be in a normal buying mode, which will increase bidding for crude oil available on the open market and will further tighten the supply.



Winners and Losers

The losses associated with the drastic crude oil price reduction are not shared equally. Countries that depend largely on income from the sale of exported crude oil and companies which only produce oil, or support production, are taking the biggest hits. Economics of Crude Oil Prices.

Countries that produce no oil, but consume oil, have been blessed with huge savings this past year. Major, fully integrated oil companies have seen losses in crude oil production, but savings at the refinery in their purchase price of crude oil. In some cases, product prices have not completely followed the price of crude oil downward, so there remains some profit on the sale of products.

Above all, U.S. consumers and the U.S. economy has benefited enormously from the price decrease. As consumers of 26% of the world's resources, collectively, we saved 21 billion dollars in the past 9 months.

On the other hand, those institutions that invested heavily in foreign economies that were largely depending on cash flow from crude oil are now seeing losses. Some countries that depended on revenues or income from those investments are failing. The situation is complex -- better left to the world's economists to sort out. But there's no question that over-production of crude oil in the winter of 1997-1998 played a key role in producing the world's economic problems.

REGIONAL FORECASTS

U.S. crude oil inventories decreased by 2.4 million barrels from 328.1 to 325.7 million barrels. The decrease occurred largely due to low level of purchases of imported crude oil. Input to refineries increased an insignificant amount from 15.520 to 15.560 million bpd

(98.9 % capacity). Prices of gasoline remained unseasonably low, while refiners managed to edge diesel prices slightly higher.

The short term gasoline price forecast reflects the anticipated shortage of gasoline due to likely logistics problems in U.S. refineries this fall as refiners deal with burgeoning inventories of distillate (heating oil). West Coast prices are predicted to increase in concert with East Coast prices and crude oil prices.
Forecast Graphs

EIA U.S. Refining Data

	Input/Output	Million BPD	Imports	Million BPD	Inventory	Million BBL
Week	Sep 4	Sep 11	Sep 4	Sep 11	Sept 4	Sep 11
Crude Oil	15.520	15.560	8.487	8.631	338.1	325.7
Gasoline	8.237	8.193	0.524	0.460	207	205.7
Distillate	3.476	3.669	0.181	0.173	144.7	148.7
Resid	0.694	0.751	0.325	0.291	39.0	39.0

World crude oil prices reported by EIA as of September 11: Arabian Lt (34 API) - $12.55, Nigerian Bonny Light (37 API) $12.80, UK Brent (38 API) $12.82, and Mexico Maya (22 API)- $8.92.

Posted prices for crude oil as of Sept 20, 1998 were: Scurlock, West Texas Intermediate (WTI), $13.00; Louisiana Lt. Sweet Onshore $12.50, Oklahoma Sweet $13.00; Kern River (13 API) $9.50; Kettleman Hill (34 API) $12.95; and Wilmington (17 API) $10.10

East Coast Gasoline and Heating Oil

East of the Rockies - Production of gasoline in PADDs I and III was lower than the previous week. PAD II production increased a small amount. Overall, gasoline stocks remained about the same in the East.

EIA reported gasoline prices per gallon for Regular on September 14 were as follows: PAD I - $.98, PAD II - $.99, and PAD III - $0.94.

The price of diesel on September 14: PADDs I - $1.02, PADD II - $1.00, and PADD III - $.99.

FORECAST: Gasoline prices will follow the price of crude oil, while competition among the many eastern refiners will keep oil company margins slim. The price of heating oil should be low through the winter of 1998-99, but the price may inch up as the price of crude oil increases depending on the amount of competition that occurs between vendors.

Rocky Mountain Gasoline and Diesel

Rocky Mountain - the price of regular gasoline increased to $1.11 per gallon and the price of diesel remained at $1.08 per gallon.

Prices should remain stable through September, then may increase with the price of crude oil.

West Coast Gasoline and Diesel Forecast

West Coast - Refiners increased crude oil input to crude stills, produced less gasoline and more diesel and residual oil. Gasoline inventories dropped from 28.1 to 27.3 million barrels while inventories of diesel increased from 9.1 to 9.9 million barrels. Overall, the West Coast system remains balanced.

Stocks of residual oil were moved to market, or upgraded bringing inventories back down to normal levels.

Product prices remain reasonable, although some prices in California increased this week. On September 14, the average price of (reg-mid-premium) gasoline in PAD V was $1.17 per gallon. The price of Regular in PAD V was $1.13.

The average price of diesel in PAD V increased to $1.10 and Californian's are still paying $1.16.

FORECAST: The price of gasoline and diesel are expected to mirror increases/decreases in crude oil in the near term. It remains to be seen whether competition among the western refiners will keep pricing under control.

Imports

Imports - The 4-week average for gasoline imports decreased from 524 to 460 thousand barrels per day. Distillate imports decreased from a 4 week average of about 180 to 173 thousand bpd, and will remain low due to lack of storage space. Imports of residual oil decreased from 325 to 291 thousand barrels per day.

Back to Top

Main Current Industry Forecast Questions & Comments Graphs Links of Interest