Volatile times, volatile prices

On page 6 of the April 2011 issue of Fuel Oil News, Dr Craig Lowrey, consultant for UX Energy Services, asked if 2011's volatile start was a sign of things to come for the rest of the year

Having passed the year's halfway point, Dr Lowrey says: "It's fair to say that the answer to my previously posed question is "yes" but, that determining what will happen in the rest of the year is unclear." Dr Lowrey expands on the subject below.

The oil price started at around $95 per barrel back in January - but due to uncertainty about economic growth in China and the US, ongoing unrest in the Middle East – particularly Libya – and the prospect of additional fossil fuel demand from Japan following the earthquake and tsunami in March – by April, the oil price was at $120 per barrel.

These factors, which dominated global crude markets throughout spring, were joined by ongoing doubts over the Eurozone's stability and the risk of a Greek debt default and its broader implications.

> *how much domestic and commercial consumers pay to heat and light their properties is being determined by events well beyond the control of any single government or agency*

OPEC arguments, Saudi Arabian intentions and IEA action

On the supply front, the loss of more than one million barrels of crude oil per day from Libya was the main talking point. At its meeting at the start of June, there had been hopes that OPEC members would agree to a formal increase in production levels. Those hopes were, however, dashed after a proposal put forward by Saudi Arabia to increase the cartel's output by 1.5 million barrels per day was vetoed by nations including Iran, Venezuela and Algeria – resulting in another jump in oil prices.

As OPEC members openly criticised each other, Saudi Arabia was quick to state its commitment to boosting supply, despite disagreement with its partners. The country said that, by the end of July, it intended to increase its crude output to 10 million barrels per day – an increase of 15 % on its prevailing level and its highest output in a decade.

The extent of the increase quickly raised question marks as to the feasibility of Saudi Arabia achieving this level of output - particularly when the country's pledge that it had enough spare capacity to replace Libyan shortfall did not appear to have been backed up by increased production. As oil prices climbed to more than $120 per barrel – and the International Energy Agency (IEA) warned that such price levels threatened to push the global economy back into recession – the IEA took action.

The release of strategic reserves

Following consultation with member nations, the IEA confirmed that a total of 60 million barrels per day of oil and oil products would be released from strategic reserves to compensate for the loss of supply from Libya. The move represented only the third time in the IEA's 38-year history that the strategic reserves of nations had been used in this manner – the other two being during the first Gulf War in 1990-91 and in the wake of Hurricane Katrina in 2005. The group said the decision had been made given the expectation that Libyan crude production would remain offline for the rest of 2011.

An average of two million barrels per day of oil and oil products were then released to the market over a 30-day period. The US contributed 30 million barrels or 50 % of the total, with Asia-Pacific nations providing 20 % and European countries 30 %. Despite protests from oil producing nations – particularly those in OPEC, who accused the IEA of market interference – the agency pointed out that the move was merely a stop-gap measure until OPEC or Saudi Arabia was in a position to increase supplies, and that the move would be reviewed after the 30 days.

In late July, the IEA announced it had no further plans for another stock release; its aim of replacing Libyan production had been achieved and additional production had indeed been made available by OPEC.

> *the secondary objective of reducing prices was, however, not as successful*

The secondary objective of reducing prices was, however, not as successful. While the crude market fell by approximately $8 per barrel to around $105 per barrel, prices rebounded over the course of the 30-day period, to again approach $120 per barrel.

Financial market instability reflected in prices

While global crude consumption is still forecast to recover in line with the global economy – the latest estimate from the IEA for 2011 oil demand is 89.5 million barrels per day – the risk of financial market instability has been ever-present. The potential for a Greek default on its debt, coupled with the risk of contagion spreading to other Eurozone members, including Portugal and Ireland, has meant that each piece of news on this issue has been acutely assessed by oil market participants and reflected in prices.

Likewise, the risk of default by the US on its sovereign debt obligations provided further volatility for oil markets, given the nation's status as the world's largest fuel consumer. While a deal to increase America's debt ceiling has been reached between the Democratic-led Senate and the Republican-led House of Representatives, the downgrading of the country's credit rating – and its implications for the US and wider global economy – remain evident.

Against this challenging and dynamic backdrop, it is fair to say that oil market volatility shows no sign of abating and, may well increase still further. One thing that is clear is that the price of crude oil that determines – to a large extent – how much domestic and commercial consumers pay to heat and light their properties is itself being determined by events well beyond the control of any single government or agency.