Oil Markets And SPR Policy

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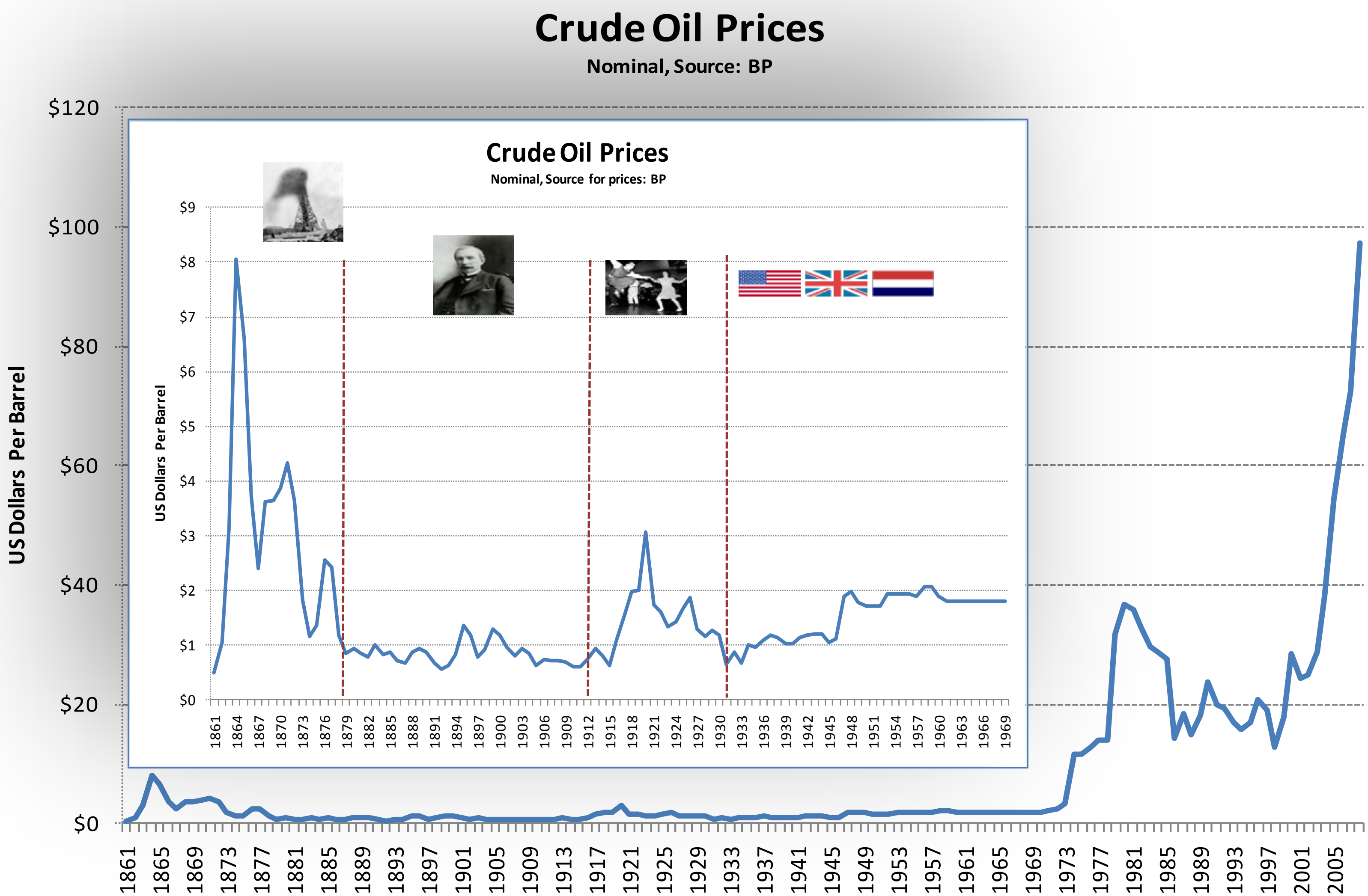
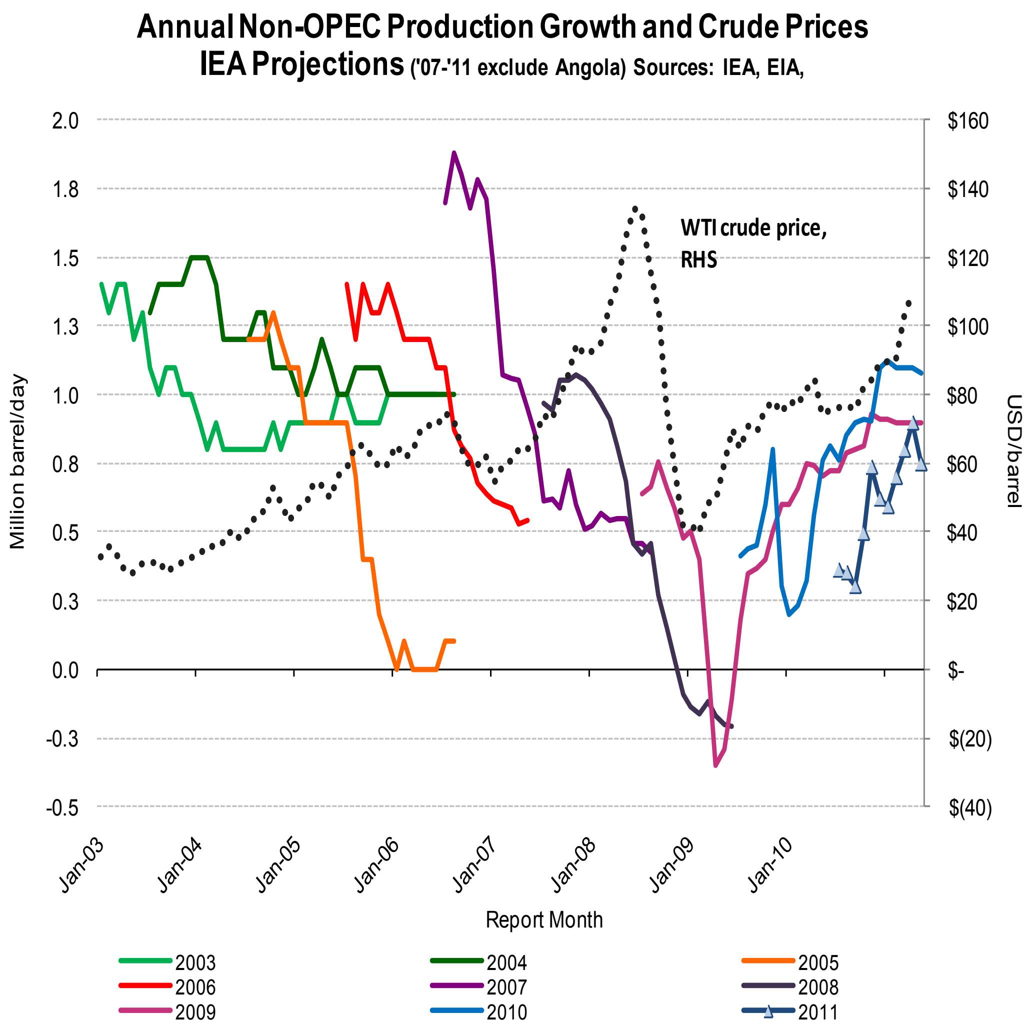
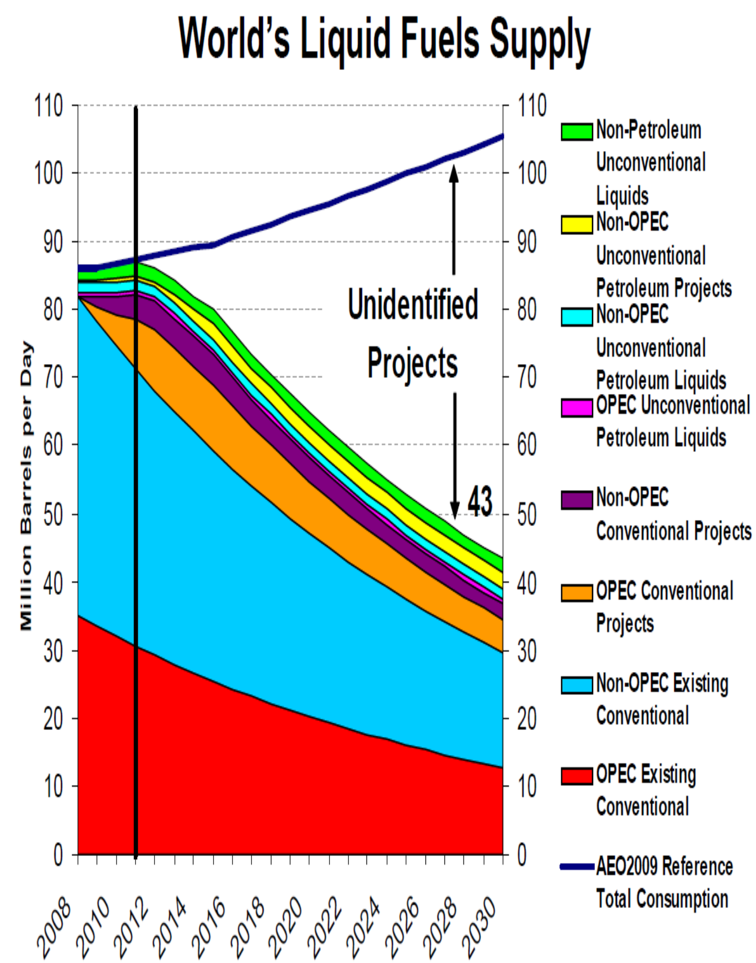
Structural Shift To Higher Price Level Discounted, Greater Price Swings Not



1861-1944 US Average.
1945-1983 Arabian Light posted at Ras Tanura.
1984-2008 Brent dated.

'03-'07: We Learned the Supply Curve Is Steeper Than Previously Thought





Source: EIA, AEO2009

Next Big Debate: How Thirsty for Oil Is Non-OECD GDP Growth?

Consensus may be lowballing oil intensity of EM GDP growth

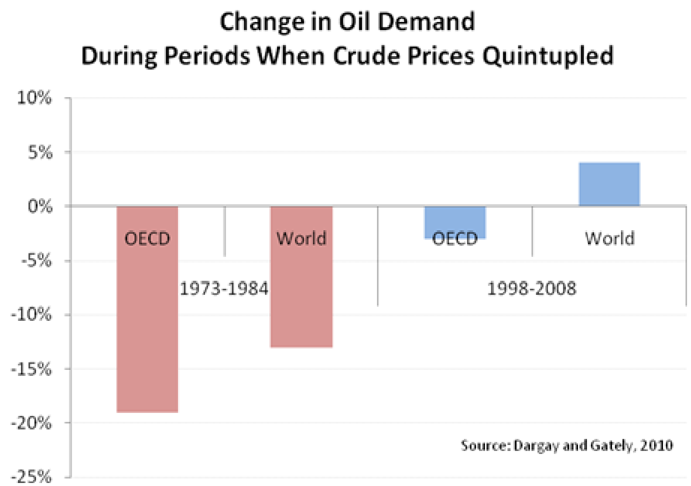
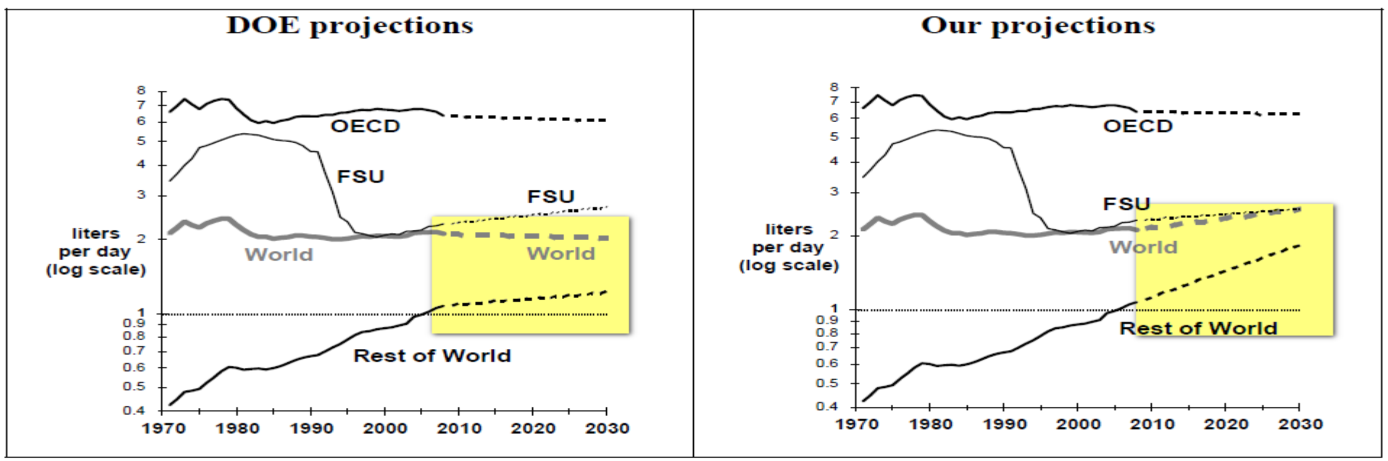


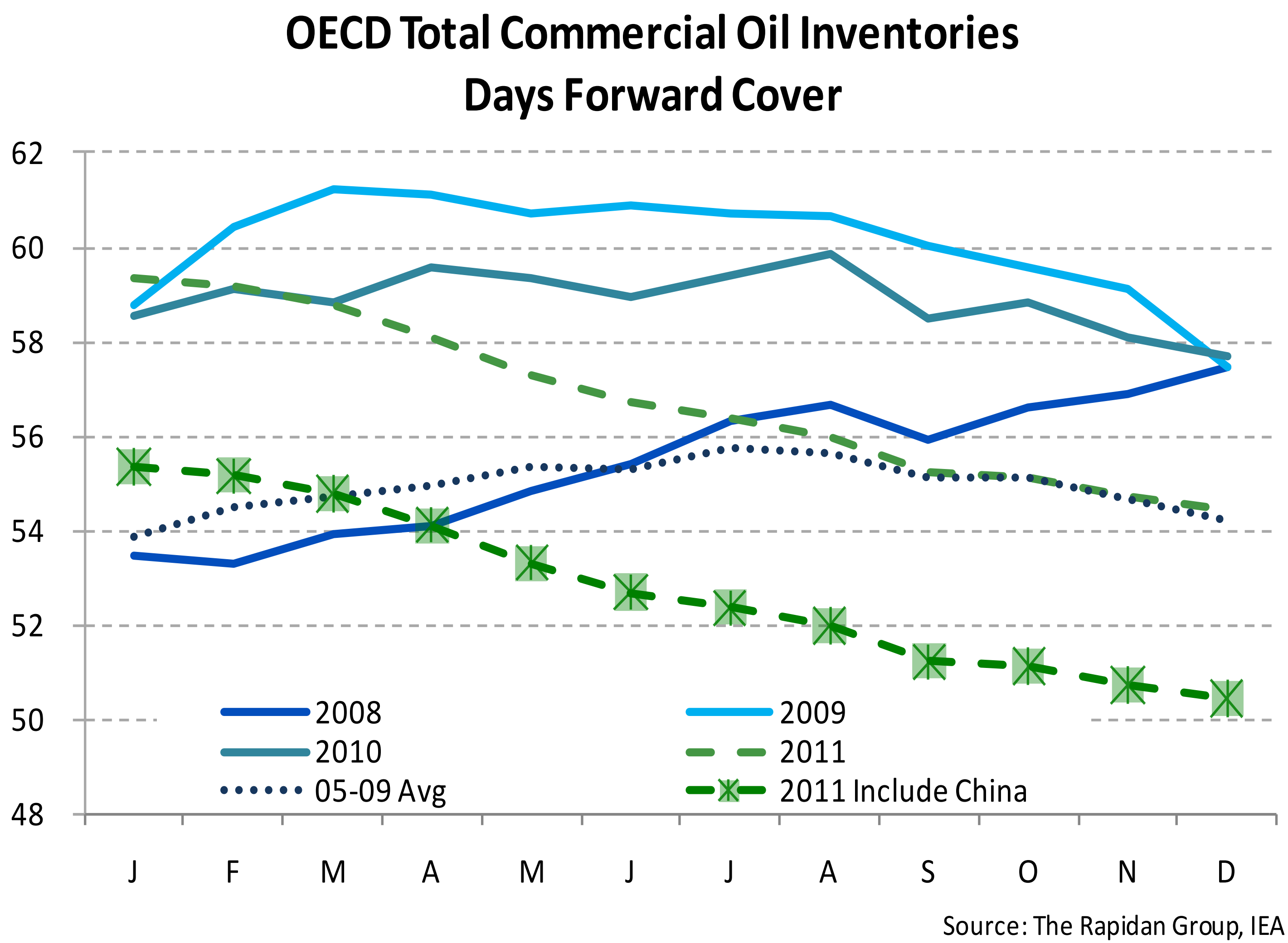
Figure 15. Per-capita oil demand 1971-2008, and projections to 2030 using DOE Reference Case assumptions for crude oil prices and income growth: DOE projections and Our Projections



World oil demand's shift toward faster growing and less price-responsive products and regions, by Joyce M. Dargay and Dermot Gately, February 2010

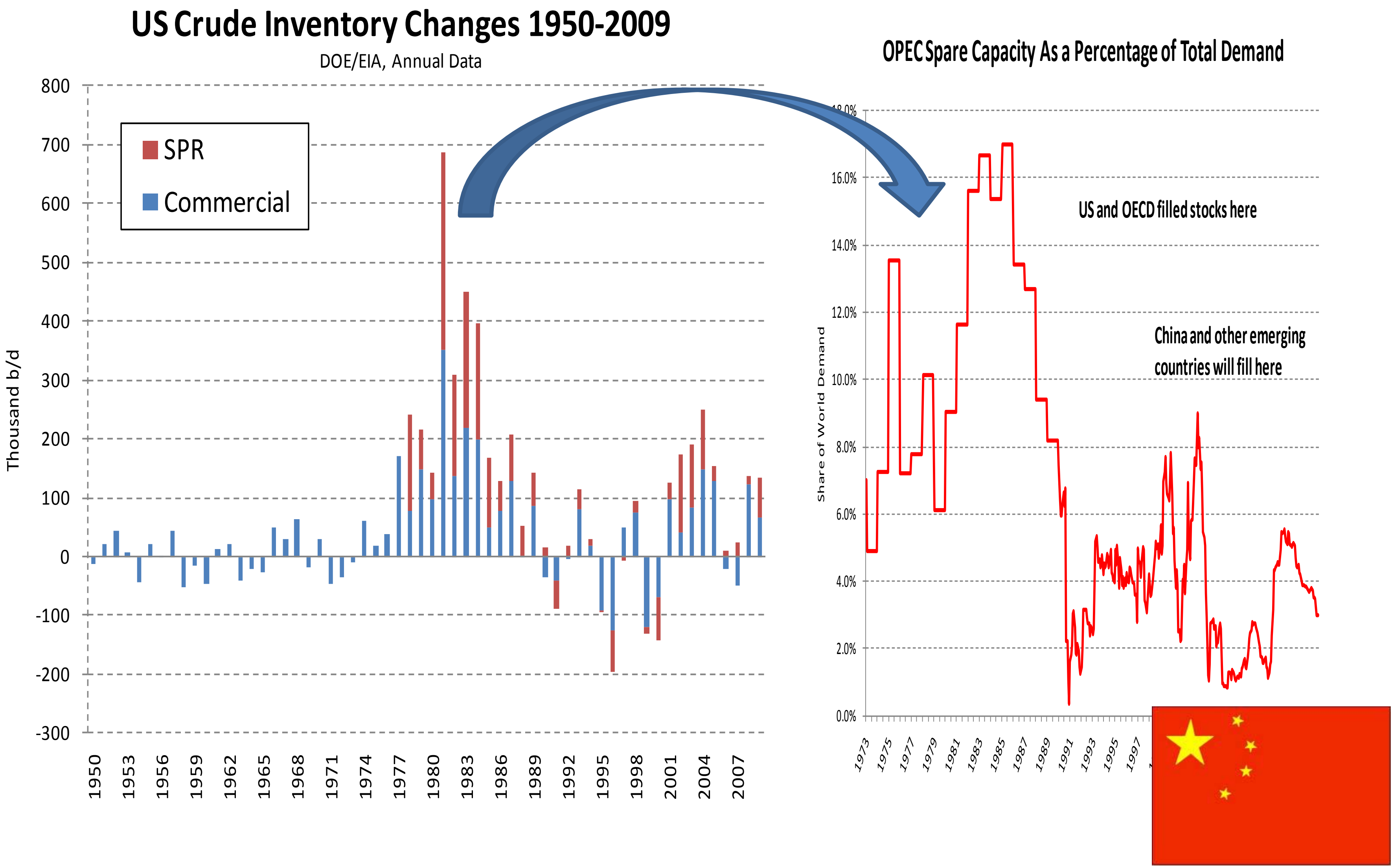
http://www.econ.nyu.edu/dept/courses/gately/OilDemandDargayGatelyFeb2010.pdf

Our Old Familiar Metrics Don't Help As Much As They Used To



China Is Scrambling to Build Stocks In a Tight Market

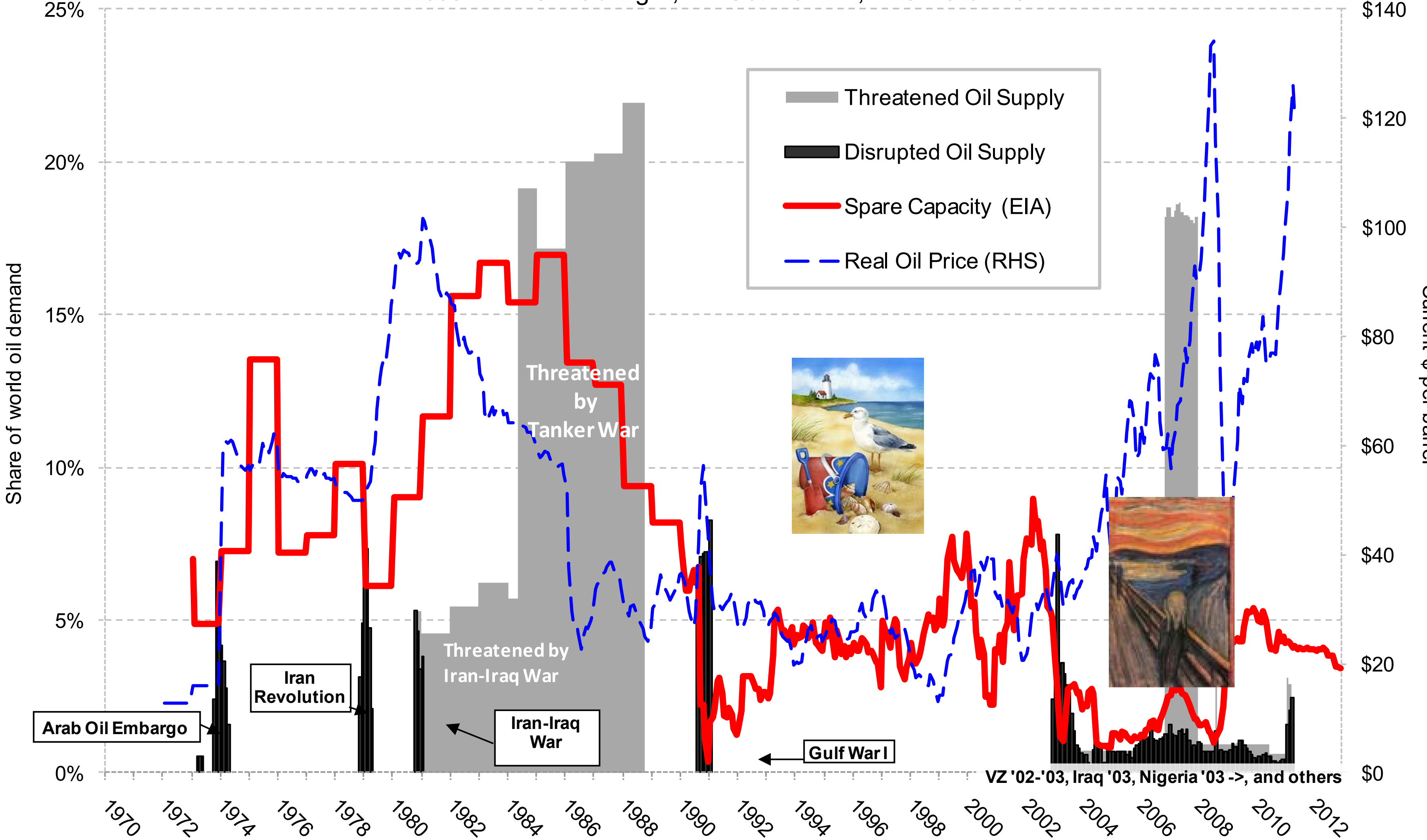
The US was luckier – we filled during recessions and non-OPEC supply surges



Putting It All Together

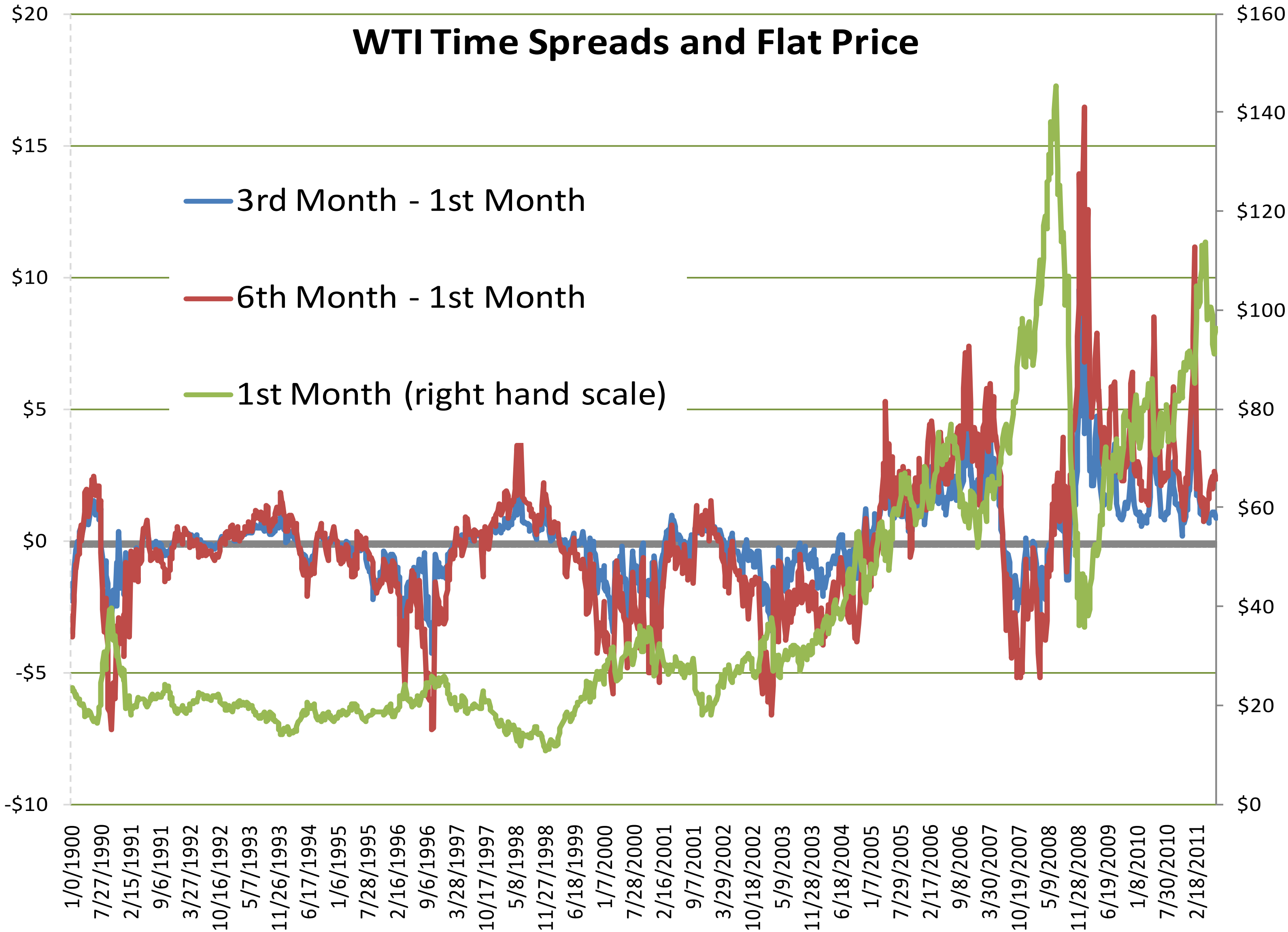
Oil Disruptions, OPEC Spare Capacity, and Crude Prices

Prices: '72-'73 Arab Light, '74-Oct '10 WTI, Afterward Brent

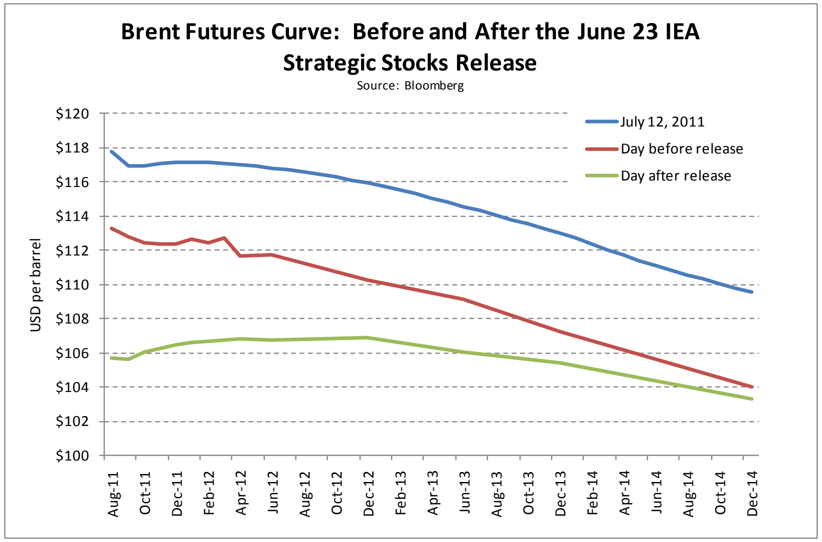


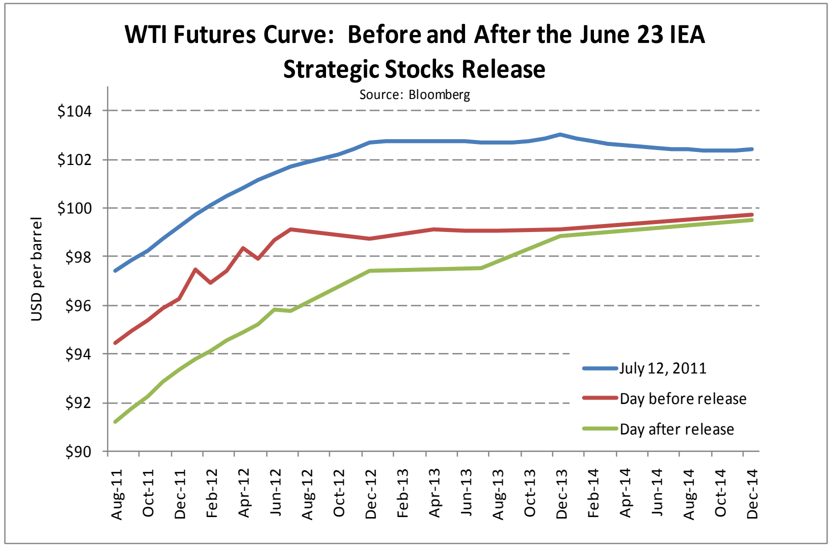
The Rapidan Group, EIA

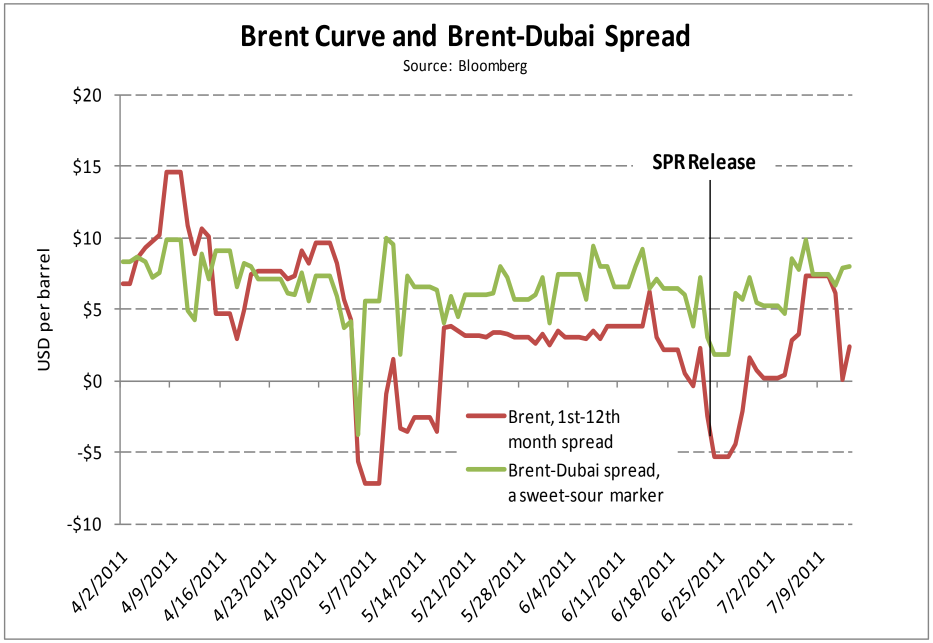
Would the Futures Curve Help Guide SPR Intervention Decisions?



What Did The Recent SPR Drawdown Achieve (And Will It Be Repeated?)







Should we stick with current emergency-only policy or shift to active use to smooth price fluctuations? Stick with emergency-use only. Especially now.

Better to stick with emergency –only than active use.

- Private industry could hold lower stocks.
- Insufficient information about global fundamentals; wouldn't know when to intervene.
- Curve not sending clear signals
- Intervention decisions would be politicized (there is precedent)
- OPEC can offset (OPEC cut 1.5 mb/d shortly after Sep 2000 SPR use)
- Not clear international support - countries going it alone, reduce effectiveness
- If we tried and failed, SPR could lose what psychological impact just having it confers now.
- If officials attempt to spend strategic stocks to prevent prices from clearing , they will lose those stocks to the market. Officials may win the first rounds, but traders will win the match. (Risk second or third SPR release could start the feeding frenzy.)

Especially now

- Budget austerity: Temptation to sell SPR to raise revenue (such as 1996) and resistance to spending funds to refill (Congress has not authorized purchase since 1994).
- Market undergoing structural shift - price mechanism returning to balance the market. Low price elasticity of demand and supply = bigger price swings than we're familiar with in recent memory.
- Political class is traumatized and confused - not conducive to wise policy decisions. As they realize OPEC's control is waning, they will be tempted to use strategic stocks to cap prices I'd guess around $110 WTI/$125 Brent. Better ways to manage price swings.

Close calls

- Dec 2002 - Venezuela cut off: Yes, but imminent Iraq invasion caused us to keep powder dry.
- June 2011 - Libya: not my call but in the grey zone...just don't get used to it.

Thank you!