PIRINC

A Short Term Outlook For Prices Or Irrational Exuberance?

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Why Hasn't Iraqi Oil Had a Bigger (Negative) Impact on Oil Prices?

1) A number of analysts have been puzzled by the fact that Iraqi oil has not had a noticeable negative impact on oil prices.

2) Some have jumped to the conclusion that since we haven't seen a price decline by now we are unlikely to see one during the remainder of 1997.

3) In fact, some OPEC observers and spokespeople are suggesting that we've already entered a "new millennium" at least for oil prices. They suggest that the $15/20 oil world of the past decade is history and that prices will now trade in a $20/25 (Brent Basis) range as far out as one can see. Maybe, but it suggests a certain degree of near sightedness - certainly prices will trade in that range during the near term i.e. next 90 days, but what happens then?

To answer the first question it's important to understand that there have been a number of interesting coincidences (at least three) that have helped prop up oil prices.

a) The timing of Iraq's re-entry could not have come at a more opportune time for producers. The first loadings of Iraqi oil occurred with the advent of the beginning of winter when world demand is at its peak.

b) Secondly, the volume of oil that Iraq will be allowed to sell in the first 90 days coincidentally happens to nearly approximate the inventory "shortfall" of approximately 50 million bbls.

c) Third, the 500,000 b/d of Iraqi sales since December 20 has been fully offset by the more than 500,000 b/d increase in European heating oil demand (vs. normal) as a result of the exceptionally cold weather in Europe since December 20.

(Jupiter does occasionally align with Mars.)

The second question is what happens at winter's end. We do know that winter will come to an end, at least in the Atlantic Basin sometime in March. Just about the time our analysis suggests that global stocks (year-on-year) start to improve.* Globally there is at least a 3 million bbls/day swing in demand between the 1st and 2nd quarter. However, while there is some crude oil production maintenance that starts in the 2nd quarter there is almost no measurable pronounced seasonal swing in supply.

Thus, as the following table suggests, if producers are reluctant to voluntarily shut in production, inventories in the 2nd quarter will have to build by 3 million b/d.

The question is why would buyers take oil they don't immediately need at today's price signals (and in a severely backwardated market which penalizes inventory accumulation). If the balances are approximately right the answer is (by May)** they won't without a material downward shift in price.

1997 (MMB/D)

	1Q	2Q
Demand	**74.9**	**71.5**
Supply		
Non-OPEC*	**48.0**	**47.8**
OPEC	**26.6**	**26.8**
Stock change	**(-0.3)**	**(+3.1)**

*** includes OPEC NGLs and Condensate**

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* Due to sizable refinery turnarounds in the U.S. during the 1st quarter, gasoline and distillate stocks will remain relatively tight through March.

** Could very well occur earlier.