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WORLD OIL OUTLOOK: WINTER 92/93

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Crude Prices Below Year-Ago But Will Rise Seasonally

Let me start my world oil outlook for the winter of 1992/93 with the current price of oil. For WTI the average price for the first half of October is $21.97 per barrel. For the OPEC basket price it is $19.30. These prices can hardly be called excessive. They are nearly $1 lower than last year's comparable prices and only about 10% higher than prices in October 1989, the last year before the Gulf War. What makes them interesting is that they are at this relatively low level despite the fact that Iraq, a 3.4 million B/D producer before the Gulf War, is still not exporting any oil, that Kuwait production is still below its pre-war volume, that Soviet supplies are still declining, as they have every year since 1989, and that the economies of the OECD nations are beginning to show some growth relative to their performance in 1991.

As demand picks up seasonally we can expect crude oil prices to rise seasonally, perhaps to OPEC's target price of $21. But considering the developments I just enumerated, this would be a relatively modest increase and, would be limited to the prime heating season.

Of course, I have to put in the standard disclaimer that unpredictable extraneous factors such as unusual weather conditions, supply disruptions or the resumption of Iraqi exports during the period under discussion could substantially change this price scenario. But what we are witnessing right now is a continuation of what we have seen since the end of the Gulf War in February 1991, namely, that the world oil market can operate effectively and competitively even with a very small margin of spare capacity. In 1991 when economic activity in the OECD was stagnant this was, correctly, viewed as one reason why there was no upward pressure on prices in the face of so little spare capacity. However, this year world oil demand outside the CIS* will be about 1 million B/D, or 2%, higher. Yet, prices, so far, have not. We expect this to be changed in the near future but primarily for seasonal reasons.

World Supply and Demand: Production Capacity Utilization High, Price Increases Moderate

Now let us take a look at the world supply and demand, as we see it for the 4th Quarter 1992 and the 1st Quarter 1993.

For our purpose we have excluded CIS supply and demand from our world balance because of the unique changes taking place there and the fact that OPEC exports, the world's marginal supply source, are still affected only by CIS net exports.

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* Commonwealth of Independent States (former Soviet Union)

World Supply/Demand, exCIS*
(million B/D)

	4th Quarter		1st Quarter	
	1992	**1991**	**1993**	**1992**
World Demand ex CIS	61.2	60.1	62.0	60.7
Non-OPEC Supply	32.0	31.6	32.2	31.7
CIS net exports	2.1	1.8	1.7	1.4
	34.1	33.4	33.9	33.1
Balance required	27.1	26.7	28.1	27.6
of which OPEC NGLs	2.0	2.0	2.1	2.0
Required OPEC crude and stocks	25.1	24.7	26.0	25.6
Memo: Stock Changes		-0.6		-1.6

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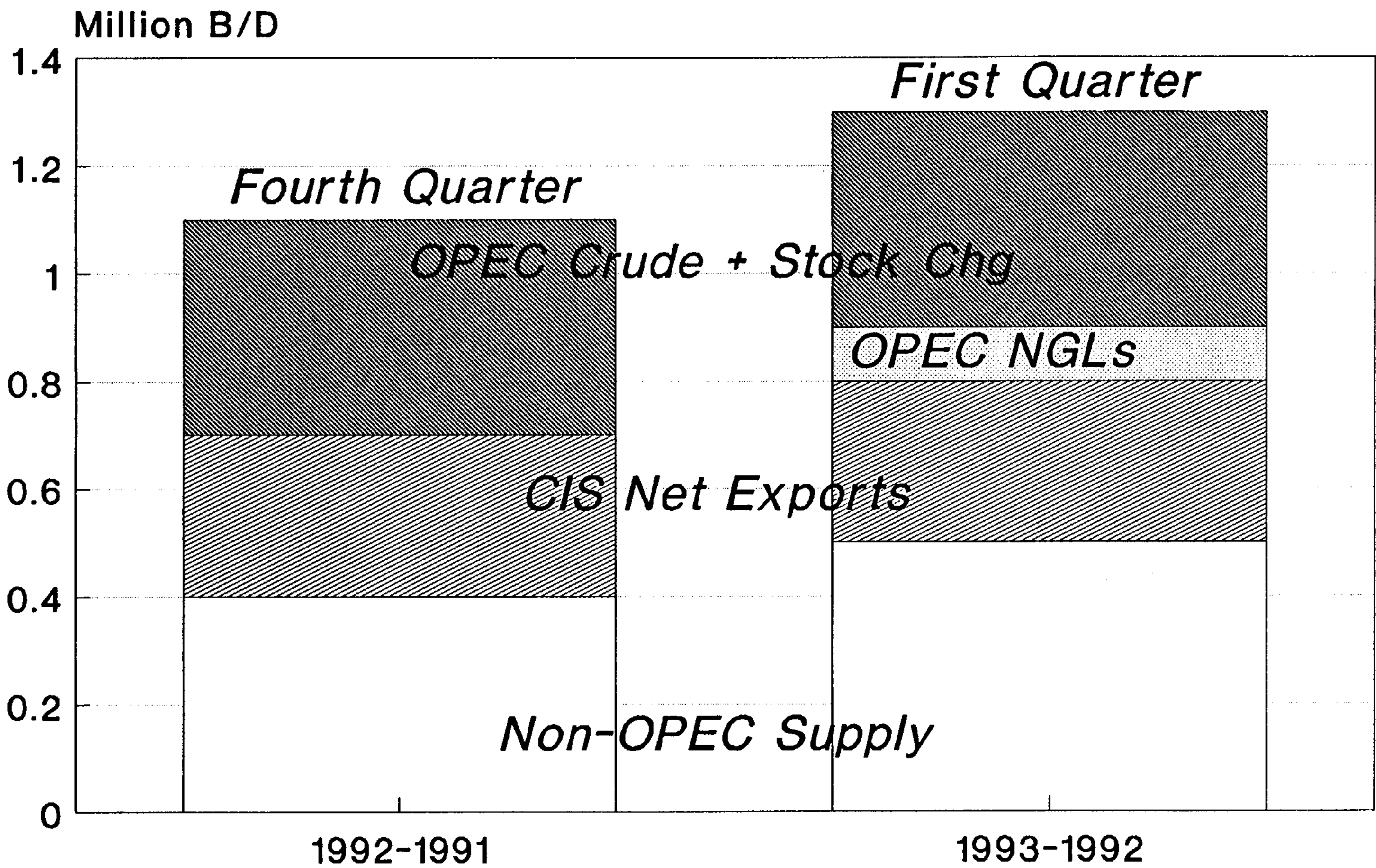
On the demand side the 4th Quarter represents a respectable increase of 1.1 million B/D, or 1.8%, above the 4th Quarter of 1991. On the supply side the balancing item of 25.1 million B/D of OPEC crude and stocks is slightly larger than the 24.7 million B/D of the 4th Quarter 1991. Current OPEC capacity of about 26 MMB/D is sufficient to meet this requirement without any stock draw. That does not mean there won't be a draw or a build in the 4th Quarter. But OPEC's current sustainable capacity does not physically require a stock draw to balance supply and demand under our price and other assumptions.

In the 1st Q '93 the 26 million B/D demand for OPEC crude and stocks could technically still be met by OPEC crude alone, assuming further increases in Kuwaiti and Iranian capacity between now and year-end. However, OPEC would then operate almost at physical capacity which would have an upward impact on prices early in the quarter. But it will of course not be required to do so since the 1st Q is always the prime period for inventory reduction. True, commercial stocks in the OECD countries are somewhat low right now which may add to the upward price pressure. But a stock draw of 500-800 MB/D in the 1st Q '93 is doable and likely. This would reduce required OPEC output to not much more than our expected 4th Q level. According to our table, this stock draw is substantially below the year-ago level. The reason is the rehabilitation of Kuwait production since then which has added more than 1 million B/D to OPEC's productive capacity.

Changes in Supply/Demand Balance
(World, ex CIS*)



*Commonwealth of Independent States

OPEC: "Market Shares" Not Quotas

I have not mentioned OPEC's role in setting production quotas for its members in my world market analysis. The reason is that for the period under discussion it is likely to be irrelevant. At present OPEC has no production quotas, only a suggested general guideline of what it has decided to call "market share" for want of a better non-controversial term. I don't expect this situation to change at the next OPEC meeting in November. On the contrary, with prices higher by then and production moving closer towards capacity a roll-over of the current do-nothing policy is the most likely practical outcome of the meeting, regardless of what the communique says.

However, as we get into the second half of the 1st Q '93 OPEC will probably have to take some effective action to curb the output of its key members if it is to avoid a sharp post-seasonal price drop.

The Big Unknown: Iraqi Oil Exports

Iraqi oil exports, with a likely initial volume of 1-1.5 million B/D, are a dark cloud on the oil producers' horizon at this point. When, how and with what force this cloud will burst onto the market is of course anyone's guess at this point. Some experts think it will occur shortly after the U.S. election for a variety of political reasons, others are convinced it won't happen as long as Saddam Hussein remains in power. It is safe to assume there won't be any Iraqi oil exports this year but they will resume sometime in 1993. When they do, the market will probably react quickly with a price reduction. OPEC is of course aware of this and has a standing resolution to call an emergency meeting whenever Iraq returns to the world oil market. It is doubtful that OPEC can or will act to fully offset Iraqi oil exports. In all probability the return of Iraq to the market will put downward pressure on world oil prices for some time.

The U.S.: Distillate Demand Up, Prices Follow

Now let me briefly touch on the U.S. market which has already been covered quite extensively by the previous speakers. Total U.S. oil demand will show a small increase -- about 1.5% -- this year, following two straight years of decline. The increase reflects both the assumption of normal winter weather this year, compared to warmer-than-normal (1.7% fewer degree days) last year and a modest economic recovery compared to last year's 1.3% decline in GNP.

In the Northeast (New England and Middle Atlantic) where 44% of all residential units are oil heated and which accounts for 90% of total U.S. oil heating, degree days were 6% and 4% respectively below normal in the 4th Q '91 and the 1st Q '92. Normal degree days plus the beginning of economic recovery should raise demand for middle distillate

heating oil by 4-6% in the 4th Q '92 and the 1st Q '93 over the comparable periods of the previous year. Under normal or moderately colder-than-normal weather conditions there should be no problem in obtaining these volumes. However, prices will be above last year's depressed level, both because of the aforementioned higher crude oil cost and the increase in distillate demand.

If there is extremely cold weather the distillate situation could be exacerbated by the current natural gas problem. Natural gas stocks at the beginning of the prime heating season are expected to be below the year-ago level because of the disruptions caused by Hurricane Andrew. Meanwhile, unused gas deliverability will have all but disappeared by the 1st Q '93. Thus, in any sustained severe cold spell interruptible gas consumers in the industrial and electric power sectors are likely to switch to distillate fuels on a larger scale than in the past. This would put additional pressure on distillate prices. However, refiners should be in a better position to maximize their distillate yield in response to this situation because the mandatory addition of oxygenates (MTBE's) to gasoline this winter reduces the requirement for gasoline from U.S. refineries.