

# Why oil will be back on a high soon enough

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Along with the market decline, the price of oil has fallen. It's down 50% within three months. Back when oil hit \$147 per barrel in July, I said that the price "ought" to be in the range of \$100-110, with the possibility of a drop into the \$90s. That's what the fundamentals told me back then.

Most of the decline in oil price from \$147 down to about \$100 was directly related to the strengthening of the dollar. So the oil price slide in July, August and the first part of September was mostly a monetary phenomenon.

Then we had the mid-September credit crunch and market meltdown. That dragged the price of oil from \$100 or so per barrel down into the \$70s (with price excursions down into the \$60s). The demand weakness for oil has become clear in the past six weeks or so. Everybody just sort of woke up and figured out that the world was entering into a recession.

The flip side is that inventories are building back up.

This has taken down all of the oil and oil-service companies. Among the latter, **Superior Energy Services** ([NYSE:SPN](#)), **Halliburton** ([NYSE:HAL](#)) and **Baker Hughes** ([NYSE:BHI](#)) have all tumbled. Even the perennially "too expensive" Schlumberger is way down.

The thing about the oil service companies, though, is that a lot of their business is all but recession proof. And much of the oil service business is immune even to wide swings in oil prices. That is, many oil company capital budgets are drawn up a couple of years ahead of time. So oil service companies should have work despite the macroeconomic situation. Not as

much as in the boom times, maybe. But it's not going to be as bad for the oil service companies as a lot of people seem to think.

There are many reasons for this. Sometimes an oil company has leases that are going to expire if it does not drill within a certain time frame. So the oil company has to drill. Or maybe the oil company has a rig under contract. So it has to drill before the contract expires and the rig moves on to other sites. Or maybe there is maintenance or a major workover on a well or field that just plain has to get done for reasons of safety or the environment. As I said, there can be a lot of reasons.

So keep an eye on the oil service companies. As Monty Python once said, they are "not dead yet." The oil service companies are way down from previous high prices. I believe that this is a time to nibble. Don't blow your whole wad of cash, but begin to accumulate a position while we watch how the larger economy unfolds. I think we'll see stronger oil prices sooner, rather than later.

### **Oil exporters surprised, and waiting at the rope line**

Speaking of how the larger economy unfolds, some of the most surprised people on the planet are the folks who run oil-exporting countries. Hey, they believed their own press releases. They thought that oil prices would continue to rise upward, ever upward. All they had to do was figure out what to do with all the money that was going to pile up in their bank accounts. No waiting at the rope line for these worthies. But right now, demand destruction trumps even market manipulation by OPEC, not to mention the inexorable effects of depletion.

So what are the OPEC people thinking? They are hopping mad. The OPEC folks sure got used to high oil prices in a hurry. They don't like these low oil prices. It costs money to run a petro-welfare state.

According to the International Monetary Fund, Iran, Venezuela and Nigeria need oil prices above \$95 per barrel just to cover their respective national

budgets. Saudi Arabia requires oil prices above \$75 to cover its budget. Well over half of the revenues of the Russian Federation come from taxes on hydrocarbons. Mexico gets over 40% of its federal revenues from taxes on Petroleos Mexicanos (Pemex), the national oil company.

So low oil prices are causing problems for the oil-exporting states of the world. No major oil exporting country can long afford to see oil prices where they are now. Come what may, OPEC is going to turn valves and reduce supply. It's just a question of how soon this will occur, how much oil OPEC will take off the market and what that will do to pricing.

No less an authority than Hugo Chavez of Venezuela recently stated that "Venezuela can live with a price of \$90 to \$100 per barrel. But not less than that."

### **'The era of cheap oil is finished'**

According to Iranian oil minister Gholamhossein Nozari, "The era of cheap oil is finished." When a reporter from the New York Times asked Nozari what price Iran would want for its oil, Nozari declared, "The more the better." Nozari stated that he is urging his fellow OPEC members to cut production by up to 2.5 million barrels per day.

How much oil is 2.5 million barrels? By comparison, the \$6 billion **BP** ([NYSE:BP](#)) Thunder Horse Platform - 20 years in the making in deep water in the Gulf of Mexico - should produce 250,000 barrels per day by the end of 2009. So with one move by OPEC, there goes the equivalent of 10 Thunder Horses.

OPEC representatives are touring national capitals, urging non-OPEC oil producers, such as Russia, Mexico and Norway, to follow the cartel's lead and cut production, according to Reuters news services. OPEC is trying to engineer a coordinated move to drive oil prices back up over \$100 per barrel.

Most OPEC nations have already reached their own version of 'Peak Oil.'

Traditional oil-export powerhouses like Iran and Kuwait have admitted as much. Aside from Saudi Arabia, most OPEC exporters see a window of less than 20 years for significant international oil exports. By then, internal rising demand and falling output (due to depletion) will severely constrain the world oil markets. So all OPEC nations are interested in selling oil now for as much as they can get.

### **'We want the money now'**

Last May, I attended the Offshore Technology Conference in Houston. I had a revealing discussion with an oil manager who works for the national oil company of an African country. He told me this:

"The Saudis think there is an 'optimum' price for oil. They don't want to raise prices too much, too fast. They say it will kill the economies of the West. But for my nation, we disagree. There is no 'optimum' price for oil. We don't care about the economic effects on Western consumers.

If Western consumers want to drive, they will pay. Or they can walk, like millions of people do where I come from. So we pump oil every day.

We want to get as much as we can for the oil. We want the money now so we can fund the priorities of our national government. We cannot tell the people that they have to live in poverty for another generation because we are afraid that Westerners will not be able to drive their Mercedes-Benzes."

So you can see why the odds favour rising oil prices within a few months.

- *This article was written by Byron W. King for [Whiskey and Gunpowder](#)*