



2008 oil outlook for the United States and around the world

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As 2007 came to an end, oil prices approached nearly all-time highs. Adjusted for inflation, oil prices were between \$102 and \$110 in 1980; on January 3, 2008, crude oil prices reached \$100.09 on the New York mercantile exchange, and Light Louisiana sweet crude traded at up to \$103 per barrel on the spot markets in the U.S. Gulf Coast.

It is difficult to adjust to a 69% rise in just twelve months as a consumer. A gradual increase over many years would have better prepared the American public for a \$3 per gallon price at the pump along with heating oil for their homes. Yet over the last twelve months, consumers have watched their disposable income wither away and have had to adjust their spending habits. What effect this will have on the U.S. economy is yet to be determined, but with Goldman Sachs and others calling for a U.S. recession in late 2008, higher energy prices are certainly problematic. Higher commodity prices in the energy market spill over into corn and soy, as these are now petroleum replacement products. That spills over into the food the public eats, which results in higher milk, poultry, meat and wheat prices.

Barring a global recession, oil prices should decline in the next few months, as the average yearly bottom occurs in February. Prices should then resume their climb as the driving season approaches. According to surveys, Americans will still take their vacations and cut corners elsewhere in their budgets to make up for the high price of transportation, regardless of oil pricing

In the meantime, China's and India's economies continue to grow at a rapid pace, keeping their appetite for energy strong. Prices are subsidized in China to keep the economic engine fueled for growth, and the middle class continues to grow. When people feel comfortable with their jobs, they tend to spend more money on expensive items such as cars so demand will continue to be strong in these developing economies.

Russia, one of the largest producers of crude, also remains economically strong along with all the OPEC Nations' economies due to windfalls from \$95 crude oil. OPEC nations have the advantage of being able to take oil out of the ground at a much cheaper rate than many other countries. The average cost of crude extraction in the Middle East is approximately \$4. This gives OPEC Nations a \$91 profit before the product is even refined. With most nations refining their own products and light ends priced at \$107, crude oil producing nations experience windfalls from high prices. Such windfalls will cause increased spending in these countries and higher energy demand, keeping global inventories tight this year.

Several other factors contribute to high prices such as global politics, currency values, and terrorism. Many currencies are very strong against the U.S. dollar right now: the British pound has almost doubled in the past year; the Euro is very strong; and the Chinese Yuan has maintained a high value. Because oil is traded in U.S. dollars, many countries' purchasing power is reduced by the dollar's weakness, and countries require higher prices to compensate for that value.

Goldman Sachs has predicted a recession for the U.S. economy in the second or third quarter of 2008. Such a decline may largely insulate energy prices from a bearish impact of a recession. Oil markets are expected to remain tight throughout 2008, and then ease moderately in 2009. Prices should average around \$94 per barrel in January of 2008, and \$85-\$87 for the remainder of the year. As inventories ease in 2009, prices are expected to average around \$82 per barrel.

What does all this mean to the end user? Consumers should not expect prices to return to 2006 levels in the near future. They should prepare their budgets based on levels close to today, and consider locking in their costs at the two average low points for the year (February or June) for next season.

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