



## OPEC wants high oil price

By CK Wong 2006.10.06

<http://www.ck-wong.ca/Energy/opec%20wants%20high%20oil%20price%2020061006.pdf>

### Introduction

Last year this time, OPEC has been yelling loudly that the world could not sustain any above \$60 oil price and they are willing to pump up the output to ease the supply. No the tune has change. They want to maintain the above \$60 price. Why?

### OPEC and Oil Price

The price of oil is dominated by the world's largest oil export community, OPEC. This organization has Islamic Arabian countries as the majority of the members. Among them the Saudi, Iran and Iraq are the major dominated member led by Saudi. At the turn of the century oil was at the price of \$1 per barrel. Later, the Arabian found that the Western companies were just too greedy to they increase the price to \$5 and then \$10. During the '70 the world experienced the very first energy shortage: the oil shock. The price climbed to the peak of \$70. Since then there are many theory to identify that the price should harm the world economy and also the world could not bear the above \$25 oil price.

Let's assume the oil price is \$0.45 at the 1900 [1]. Please see the following table for the price of oil using various inflation rates:

Inflation	2006 Price
3%	\$10
4%	\$29
5%	\$79
6%	\$217

If you agree that the average inflation rate is a meager 3% the oil price should be at \$10. However, 5% or 6% are the more reasonable inflation rate because our money's purchasing power diminishes half for every 15 to 20 years which leads us to the price range of \$79 to \$217. This is the price when oil had ample supply and there were no shortage.

There are various viewpoints on the price that should be at \$25 rather than \$79 because of the advent of technology. Should they have a chance to appreciate how the oil is gushing out from the ground at Arabian Peninsular by the pressure from underground in 1900 to the extensive horizontal well and deep sea well they should understand the cost should be very low at \$79.

## Western Blind Spot?

Economists consistently believe that the oil price will fall because the American economy is slowing down which will reduce the oil demand. While this is correct, they have overlooked the BRIC's population is more than 20 times while the oil consumption is less than 5% of the American. When the economy of BRIC reaches the wealth critical mass, the demand for the oil will easily take over the slack from America. Is this really a blind spot or this is Western ego? The high oil price that hurt the Western economy in 1970's will still be true but the demand of the BRIC will drive the price even higher. So there will be exchange of economic superiority.

Although Hank Paulson reminds China that driving oil price high does not help the economic of China. This is a very sweet talk. Would China listen? If it does, it would not be growing as rapid as nowadays. China has recognized the benefit of free and non-state manipulated economy so that weakling will be weeded during the process. To follow this principle, the state will not regulate the oil price. In the past, suppressing of the gasoline almost kill the petroleum industry. The only way to allow the Chinese petroleum industry to flourish is to unleash the oil price. Paulson may sing the wrong song sheet this time.

## Arabian's Dream

The OPEC has been made to believe that high oil price will kill the economy. According to Matthew Simmons' *Twilight in the Desert*, high oil price does not kill the economy. Arabian does not know that and sell the oil at a low price to the American refineries which make huge profit. Now the Arabian knows the truth and wants their fair share. If American does not want their oil, they can sell it to China. The contract was signed.

The Arabian also drops the act that they have ever growing reserve. In the past, they customary increase their reserve by one or two order. With the peaking fact know, they cannot sing the song that oil should be below \$40. When the price is high, they do not pretend they can increase a few million of barrel a day to soften the demand. They want to share the profit too without the cheating overproduction.

Most recently they even say they are going to defend the \$60 price to ensure the price is above it. They are getting smart or realistic?

## Why oil price is falling?

Oil and many energy commodities do not have a lot of supply flexibility. The production and consumption are maintained in a very steady equilibrium. Most of the supply agreements are long term. Spot market is for those without agreement or a surge in demand. Although the base is huge, the variable part is small. This has to be the classic elasticity scenario. With the excess of 77 billion cubic feet in excess of 3,000 billion cubic feet can bulldoze natural gas from \$7 to \$4 level. This means only one thing, the elasticity applies to a very small amount of demand not that 3,000 billion cubic feet. With the help of rising commodity price, the hedge fund has to make some wave to make money. One hedge fund's gain will be other's lost. These are Mount Everest size waves. So those small fishes like the retail investors are caught.

## What next?

Traditionally the natural gas price will increase \$1.50 from October to November. This year, it was the meager \$0.50. This means the market is not in its consumer supply and demand mode. It is in the commodity market contract supply and demand mode. Until someone dead and last one take all they market will continue to be volatile.

## Resources

[1] *The Price of Oil: Is History Repeating Itself?*, cira 2004, Global Financial Data, [http://www.globalfinancialdata.com/articles/Oil\\_Is\\_History\\_Repeating\\_Itself.doc](http://www.globalfinancialdata.com/articles/Oil_Is_History_Repeating_Itself.doc)