

The era of cheap oil is coming to an end: oil prices set to rise over long term

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- Oil prices expected to climb to USD 55/barrel in 2009 and as much as USD 200/barrel in the long run
- Demand for oil forecasted to decline by around 1% in 2009 and 2010
- Oil to profit from flight into "real assets" coming soon

The era of cheap oil is in any case coming to an end, as easily and inexpensively built-up reserves are gradually being depleted", states Ronald Stöferle, oil analyst at Erste Group. The much higher dependence on state-owned oil groups and the now very small share in production and reserves of private-sector oil groups also points to rising oil prices over the long term. The structural problems of the oil industry were created by the failure to take action for a long time, and now we will increasingly start to feel the effects. The precise point at which the maximum rate of global petroleum extraction will be reached or exceeded cannot be forecasted. The dependence on giant oil fields and the decreasing production in many major oil-producing nations such as Mexico, Norway and the US seem to be clear signals though. "The fact that the extraction capacities of international oil corporations have generally declined in the past ten years – at steeply rising prices, tells us a lot," stated Stöferle.



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One of the positive aspects of the record levels hit by oil prices last year is certainly the public discussion that this triggered over issues like supply security and the changeover to renewable energy sources. A switch to alternative energy sources would also promote peace, because it would help to avert the growing risk of war over resources aside from being beneficial to the environment. However, as prices went down again, public discussion of the topic returned to the background.

However, Erste Group analysts point out that the longer the oil price stays in the range around USD 40 and lower, the higher and faster will supply in the future become scarcer, because investment and exploration programs will be postponed or cancelled at such prices. Right now, investments are not even 20% of the recommended volume that would be needed to boost production from currently 86 million barrels to 125 million barrels by 2030.

Demand for oil expected to decline by around 1% in 2009 and 2010

On the whole, Erste Group expects demand to decrease by around 1% in 2009 and 2010. Supply outside of OPEC is expected to shrink by almost 0.6% due to diminishing production in Russia, Mexico and the North Sea; according to the analysts; OPEC will lower extraction volumes by at least another 2 to 3 million barrels/day. At the next meeting in March, the OPEC will probably cut it by at least 1 million barrels/day. Thus, production would already be lower by a total of 5.2m barrels, which corresponds to almost 6% of total demand. In 2001, production was cut in four steps by 5m barrels (19% of total OPEC production), which had as a consequence an uptrend that lasted six years. Currently, the cuts amount to 14.5% of total OPEC production, but the economic contraction seems to be much more dramatic than in 2001.

Oil to profit from flight into "real assets" coming soon

When the monetary gates are re-opened and the velocity of circulation picks up again, a flight into real property could be triggered in a highly inflationary environment. The correlation between money supply growth and the oil price has

been shown to be strongly positive historically, which would indicate clearly higher oil prices. In such a scenario, commodities, especially oil and gold, would profit the most.

At the same time, the price of oil will no longer function according to the laws of supply and demand, but rather according to the rules of an oligopoly of few major oil-producing countries. As production is also growing more cost-intensive and only a fraction of the required massive investment volumes will be spent and many oil fields and oil-producing nations have already passed peak production, much higher oil prices may be expected again in the long run. Therefore, oil prices of USD 200/barrel are quite feasible on the three to five-year horizon.

Stabilization and slight recovery expected in 2009 – attractive opportunity/risk ratio

As the demand side is hard to assess due to current distortions, effects and duration, Erste Group analysts expect a slower upwards movement, but at the current price level there is a very attractive opportunity/risk ratio. However, we will see a renewed, strong trend phase as soon as there is a noticeable improvement of the global economic outlook. "This is why I expect an average price of USD 55/barrel for 2009, but as soon as a sustainable economic recovery sets in, the price should climb over USD 70," said Ronald Stöferle.

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