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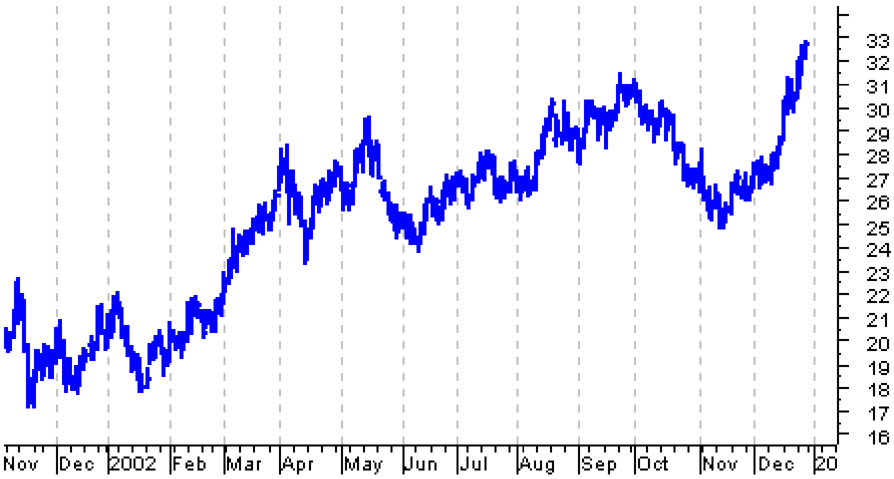
BI-WEEKLY OIL REPORT

Herodotus Antonopoulos &
Filimon Antonopoulos
Oil Market Analysts

And now what? It is the time of the year that analysts are faced with a daunting task. They gather all their wisdom, skills and imagination and try to predict what is the future going to bring to their markets. It is a task that many have tried mastering with limited success as it is not seldom that pure luck or coincidence prove to be the major determinants. As a result it is too often observed among analysts that the heroes of one year are next year's villains. We will not try to predict the future in this report but rather take a look at the past. We will describe 2002 and let you make your own judgment for 2003.

The past year started with the effects of the September 11th terrorist attack still vivid. Demand remained lackluster, US were experiencing a warm winter and OPEC had decided to lower output only after non-OPEC producers had finally agreed to proceed to small cuts of their own. There was a lot of disbelief in the markets regarding their resolve. As a result prices reached what proved to be a "year-low" of $ 17.80 on Jan. 17th. As usual, reports about the dissolution of OPEC appeared, Saudi oil minister called the end of the OPEC price band and everybody in the cartel was praying for a US economic recovery to boost demand.

Figure 1. NYMEX Crude Oil Futures ($ / barrel) - Weekly Chart



Geopolitics, however, do not follow a linear function. At about that time US Department of Energy decided to call a bidding process for crude oil for the Strategic Petroleum Reserve. Almost simultaneously US President Bush made his famous statements regarding the "axis of evil", which comprised of Iraq, Iran and North Korea and a fire in a major oilfield in

Kuwait reduced the country's oil output by 600,000 bpd. In a matter of days the world's attention shifted from the fragile demand conditions to the threats in oil supplies. It was not before long that the first clouds started appearing in Venezuela as well. President Chavez was at odds with PDVSA's management and decided to replace the company's president starting a bitter fight with the company's employees. Amid the above conditions prices recovered to $ 21.84 by Feb. 14th.

It was March however that marked the most spectacular rally. Fears that Iraq could be US's next target after Afghanistan, OPEC's decision to leave output unchanged, escalation of violence in the Middle East and threats by Chavez for military takeover of PDVSA gave a lot of fuel to the bulls. The month ended with threats from Iraq and other Arab officials, for oil embargo against Israel and the US for as long as Israel continued to use force against the Palestinians. Prices rose sharply reaching $ 28.35 on April 4th.

By that time Iraq had decided to halt exports for one month in support of the Palestinians, while protests in Venezuela were on the rise, with a general strike taking place on April 9th. On April 11th, after the killings of more than a dozen demonstrators in Caracas, part of the military ousted Chavez and placed a temporary government led by Pedro Carmona . Prices fell sharply as the new Venezuelan leaders were seen less hawkish than Chavez and markets thought Carmona would reinstate Venezuela as one of the major quota-busters within OPEC. Crude oil dropped to $ 23.30 on April 12th , down $ 5 from April 4th. In another sign, however, that Latin American politics are very hard to gauge, Chavez returned regaining power and control over the military. Prices rallied again and despite the resumption of Iraqi exports WTI reached a high of $29.54 by May 15th.

It was then that many thought that we had seen both the lows and the highs of this year's prices, as we had covered a range of $ 11.74 and almost all major events seemed to have been priced-in. The next three months suggested that they were right with prices oscillating between $ 24 and $ 26, as concerns regarding falling equity prices and the economic situation in general as well as OPEC overproduction and spare capacity were countered by strong US gasoline demand and fears about military action against Iraq.

However by mid-August the picture had changed. US rhetoric against Saddam started becoming more hawkish, while US commercial oil inventories were on a steep downtrend that had started in June and was continuing "week-in" and "week-out". Crude oil prices broke the $ 30 level reaching $ 30.32 on August 20th.

During September and early October the bullish sentiment remained intact. Bush addressed the UN and made it clear that US would attack Iraq unilaterally should the Security Council fail to reach an agreement. During the same month and early October two powerful storms, Isidore and Lili, hit the Gulf of Mexico, gravely affecting production, imports and refining and causing crude oil inventories to drop to their lowest levels in 20 years. Prices reached a new high of $ 31.39 on September 24th.

October to mid-November was characterized by the deflation of the so-called 'war premium'. Prices reached a low of $ 24.80 on November 13th, after dropping continuously throughout this 1 ½ month period. The threat to Iraqi supplies was still intact as US President Bush managed to gain authorization from the US Senate and House of representatives regarding the use of force and succeeded in setting up a UN resolution forcing the return of inspectors in Iraq. Nevertheless, the feeling that military action would not take place immediately led the market to focus on OPEC overproduction and weak economic conditions. OPEC output was at the time more than 2 million barrels per day above agreed quotas.

That did not last long however, as Venezuela came to the center of attention once again. Unions declared a general strike on December 2nd that has not stopped since. The strike has proved very effective as oil production and refining has virtually stopped. The government was forced to import gasoline to meet the country's needs and this situation has started to affect even US refiners. The withdrawal of more than 2.5 million barrels-per-day of oil production could not leave markets indifferent. Meanwhile OPEC decided to raise its quota by 1.5 million, but at the same time pledged to cut actual output by almost the same amount, as overproduction among the cartel members was rampant. The fact that OPEC was seen reducing supplies during such a volatile period added to the bullish sentiment. As far as Iraq is concerned, as we are writing those lines news appeared that US is gathering more forces in the Persian Gulf. It seems that a military operation will take place sooner or later. The issue is when it will occur and what its extend will be. Prices rallied sharply having reached $ 32.80 on December 27th, making it very likely to see even higher levels during the two remaining trading days.

During 2002 crude oil prices averaged $ 26.10 for WTI and $ 25 for Brent. This is very close to what most oil consuming countries' governments had budgeted. The fluctuation however from $ 17.80 in January to $ 32.80 in December was not something that most analysts had expected. This has been a very exciting year in the oil markets, where both bulls and bears could have seen their views vindicated or destroyed. The New Year starts with a number of major events in play and prices well above $ 30. While it is hard to predict the future we will attempt an analogy. As the beginning of 2002 marked the year's lowest prices, the first months of 2003 will most likely post the highest.

Saddam Hussein, G.W.Bush, Saudi Crown Prince Abdullah and Hugo Chavez

Wish you a Happy New Year !!!

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