

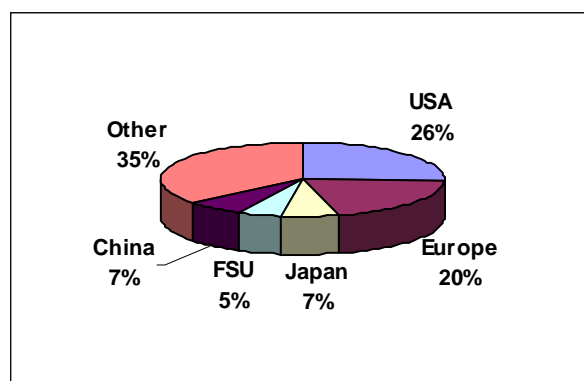
BI-WEEKLY OIL REPORT

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The American way of life has almost always been built around the ability to move, the American dream almost always included a beautiful car. By doing so the American people tied their well-being, willingly or not, to the ample availability of fuel. Oil seems to be critical not only for their industries, but also for the average American's morale. It should come as no surprise therefore, that any disruption in US oil supplies is perceived as a direct threat to the way of life. As a result one should be ready to observe exaggerated reactions in the social as well as in the political front, as war approaches and prices hit higher levels.

We will try to gauge the US oil situation by examining certain basic aspects. US is by far the world's largest consumer of petroleum, accounting for more than a quarter of the world demand. It can only cover less than half of this with its own production, thus also becoming the world's largest importer of oil and products. American fears regarding oil supplies are therefore not without justification.

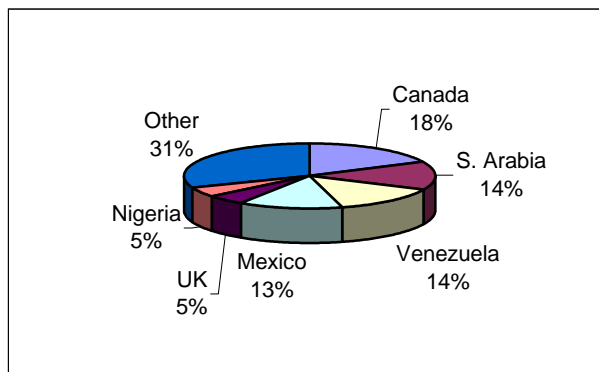
Figure 1. World Petroleum Demand



Source: Energy Information Administration

Having realized this need, they tried to diversify their sources of petroleum as much as possible, relying to the most secure producers, almost entirely eliminating Iraqi and maximizing Canadian imports, as can be observed in Figure 2.

Figure 2. Sources of petroleum imports to the US



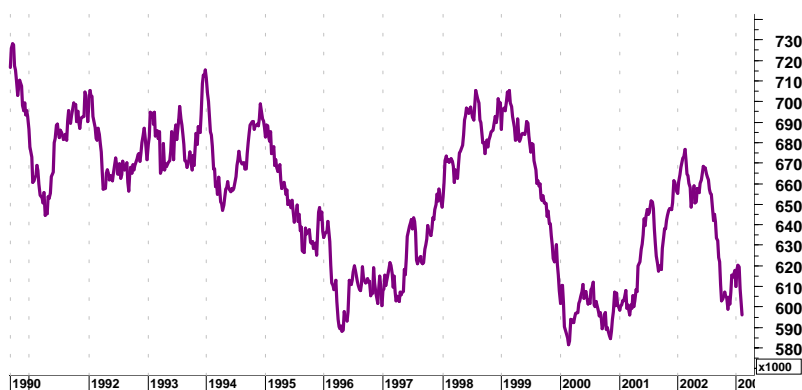
Source: American Petroleum Institute (October 2002)

By following such a strategy, authorities have tried to protect themselves from supply shocks and one could argue that theoretically if the other suppliers do not reduce shipments towards the US, a war in Iraq will have no effect at all to the country’s inventories. They felt however as stabbed in the back when the Venezuelan strike removed almost 1.6 million barrels per day from their supplies.

It was extremely hard to replace the lost barrels, especially as the neighboring countries did not have enough spare capacity to swiftly fill the gap and because a number of US refineries were set up to operate with the specific characteristics of Venezuelan crudes. It is clear therefore why the Venezuelan situation was seen by many as more threatening to the US than a possible war against Iraq.

The fears regarding supply availability can more easily be depicted if one takes a closer look at the inventory situation, after the recent crisis and during a much colder than normal winter.

Figure 3. US aggregate inventories of crude oil, gasoline, distillates (million barrels)

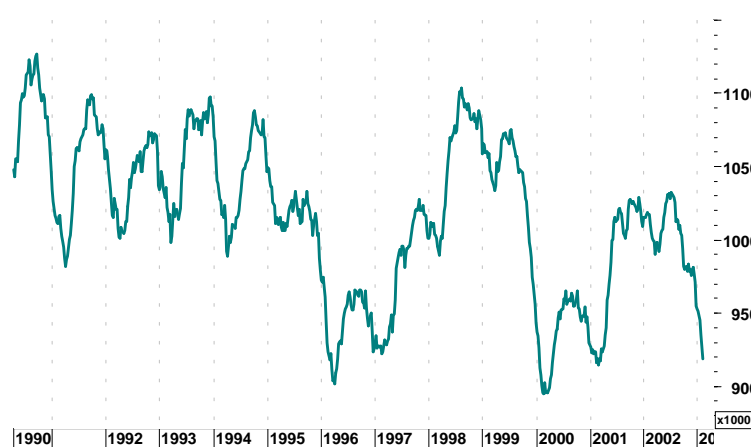


Source: Energy Information Administration

The sum of the three main categories of commercial petroleum inventories (crude oil, distillates, gasoline – Figure 3) has dropped significantly during 2002 and continued to drop in the early weeks of 2003. It is now approaching the lows that were established during 2000, a year where benchmark WTI prices reached \$37. Those are the inventory categories with direct effect to the consumers and market sentiment.

The situation is quite similar if one takes a look at the total commercial petroleum inventories (Figure 4). Concerns are raised even further if we compare the inventory situation before the Gulf War in 1991 and today. There exists a differential of almost 240 million barrels!

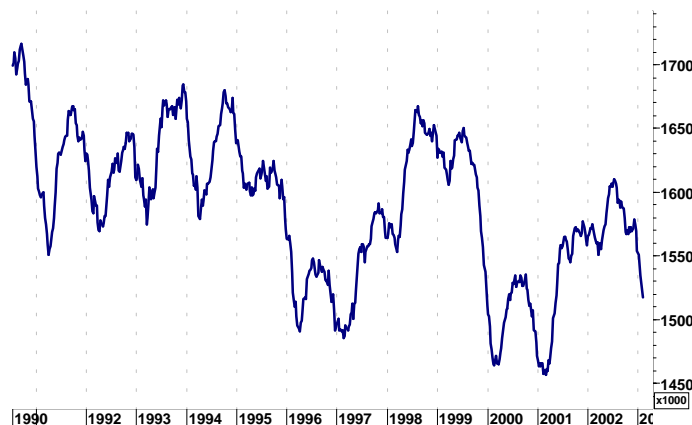
Figure 4. Total US commercial inventories (million barrels)



Source: Energy Information Administration

The situation looks however better if one adds the Strategic Petroleum Reserve (SPR) to the equation. The Bush administration was active in refilling the reserve, raising its content by 45 million barrels during 2002 to a total of 600 million barrels. It is clear therefore that part of the fall in commercial oil stocks was due to the redirection of oil to the SPR. Taking a look at Figure 5 we can see that the US market needs to lose 70 million barrels before it reaches previous years' lows.

Figure 5. Total US petroleum inventories including SPR
(million barrels)



Source: Energy Information Administration

The situation even by including the SPR in the equation is by all means tighter than it was in 1991, thus the reasons for concern remain. We would tend however to believe that in a case of a swift US victory, the effect on petroleum stocks will most likely be small and a quick recovery will follow during the second quarter of the year when demand historically drops.

On the other hand any additional supply disruption due to the spill-over effects of war, or due to any other reason (renewed tensions in Venezuela etc.) would most likely lead the already jittery American consumer to the gas pumps and would cause havoc in the markets. Seeing oil inventories drop to historically low levels will become a nightmare, not only for the oil industry, but also for the fragile economy and mainly for the political future of the US Administration. Turning the American dream into a nightmare is not the best way to become reelected. All we can wish, at the moment, is ...sweet dreams.

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