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# BI-WEEKLY OIL REPORT

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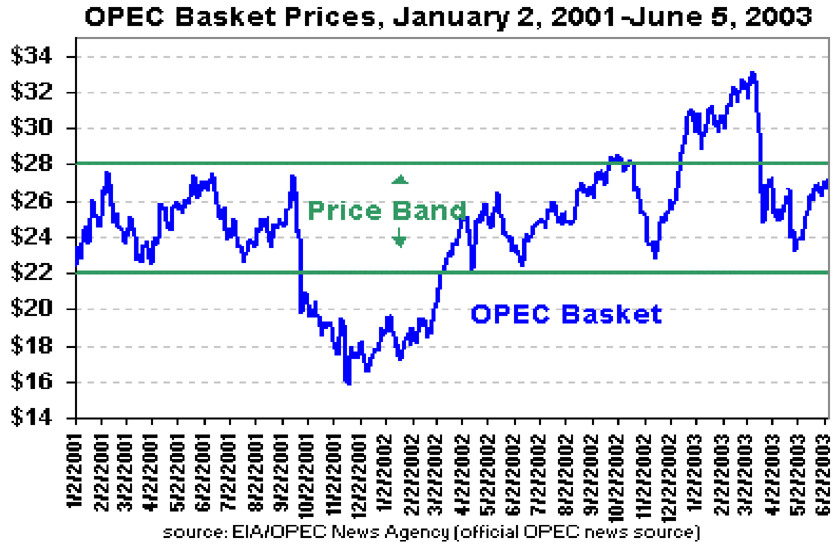
## The relativity of prices

As OPEC delegates were heading for the Organization's meeting yesterday they reiterated their objective, to secure supply for the world and stabilize prices. They have achieved their objective during the last five years, succeeding to keep prices within their preferred price range of $22-$28 for most of the time. This time however they were faced with a new obstacle - the fascinating world of currencies. As the Algerian Oil Minister Khelil mildly put it :"… we are concerned about the weak dollar".

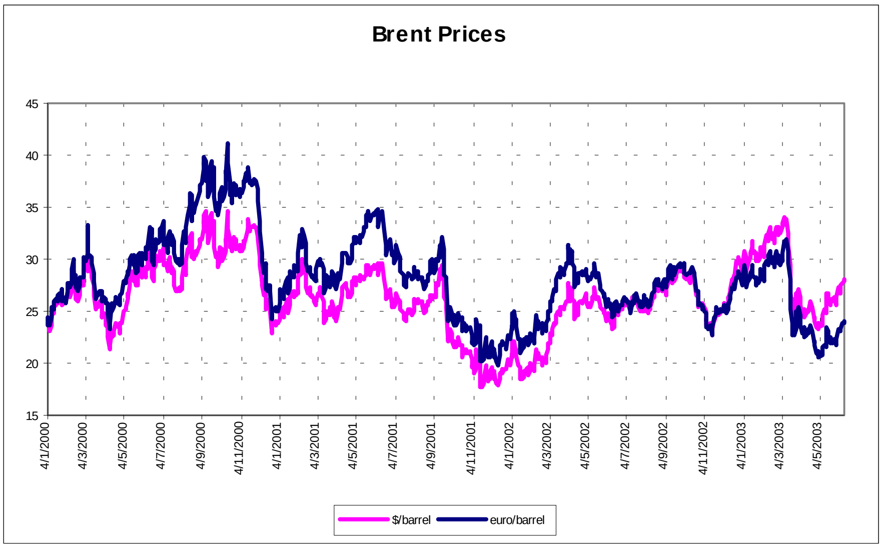
Since 1998, when OPEC tried aggressively to raise prices from the low $10's and became more efficient in controlling them afterwards, its members were blessed with a strong dollar, which not only preserved their oil income, but added even more gains due to lower import costs. Their luck started running out in 2002, but the strengthening of the euro was then seen as only a correction after four years of continuous weakness.

The situation got really scary, however, as the dollar continued its weak performance during 2003, and clear signs appeared that the US authorities felt comfortable with the situation, despite statements to the opposite. OPEC started facing the harsh reality of a fast moving world. They base their income on a volatile commodity that has now become even more volatile due to adverse currency fluctuations.

Thoughts about switching pricing methods from the dollar to the euro cannot be expressed openly as they could cause the outrage of the US at a time when relationships are already tense, but most importantly the switch would not guarantee income stability as no one can come up with accurate long-term predictions regarding currency direction. It is obvious that while OPEC feels at ease in making output decisions, it is totally unprepared to define currency policy.




What was a curse for oil producing countries proved to be a blessing for consumers outside the US. As the next chart clearly shows Euro-zone countries are now paying €24 per barrel of Brent, which has a nominal value of $28. This differential in favor of the euro is the highest since January of 1997. At the same time the US the world's largest oil consumer is facing exactly the opposite problems than the rest of the consuming world by having to pay the $28 price per barrel of Brent crude without experiencing any currency gains.



This creates a rather peculiar situation, in which producers are watching their income shrink, while at the same time the US experiences high energy prices and low inventories. There are already signs that the Bush Administration is pushing OPEC to allow for a more positive supply-demand balance in order to achieve lower prices. If, however, OPEC yields to such demands and the dollar weakness persists, its members will face even more reduced proceeds than they would otherwise have.

If one adds to the equation the expectations that, sooner or later, the US-controlled Iraqi barrels will hit the markets, it is obvious that OPEC is faced with an extremely complicated task. The Organization can neither ignore the US concerns, nor does it want to sell oil to the rest of the world at below €20 per barrel. Even if they manage to control production in a way that, under current conditions, satisfies all, a further weakening of the dollar will destroy all plans and wreck havoc among its members. To give an exaggerated example, if Euro reaches 2 versus the dollar and Brent rises to $40 per barrel, European countries will still be paying €20 per barrel of crude, while the US will be trying to cope with extremely high prices and OPEC’s income will be compromised by the currency fluctuations.

It seems therefore almost comical that OPEC was meeting today in an effort to micromanage production and preserve its beloved dollar price range when it is clear that events outside its control can make their targets look irrelevant. OPEC could be losing control on its petroleum income not due to above quota production, but due to the complexity of world economics. It would take a more integrated strategy from its part in order to secure future income, not just raising or cutting nominal production. In the meantime it feels it’s a bargain living in Europe!