Philequity Corner (May 12, 2008)
By Valentino Sy

Superspike in Oil

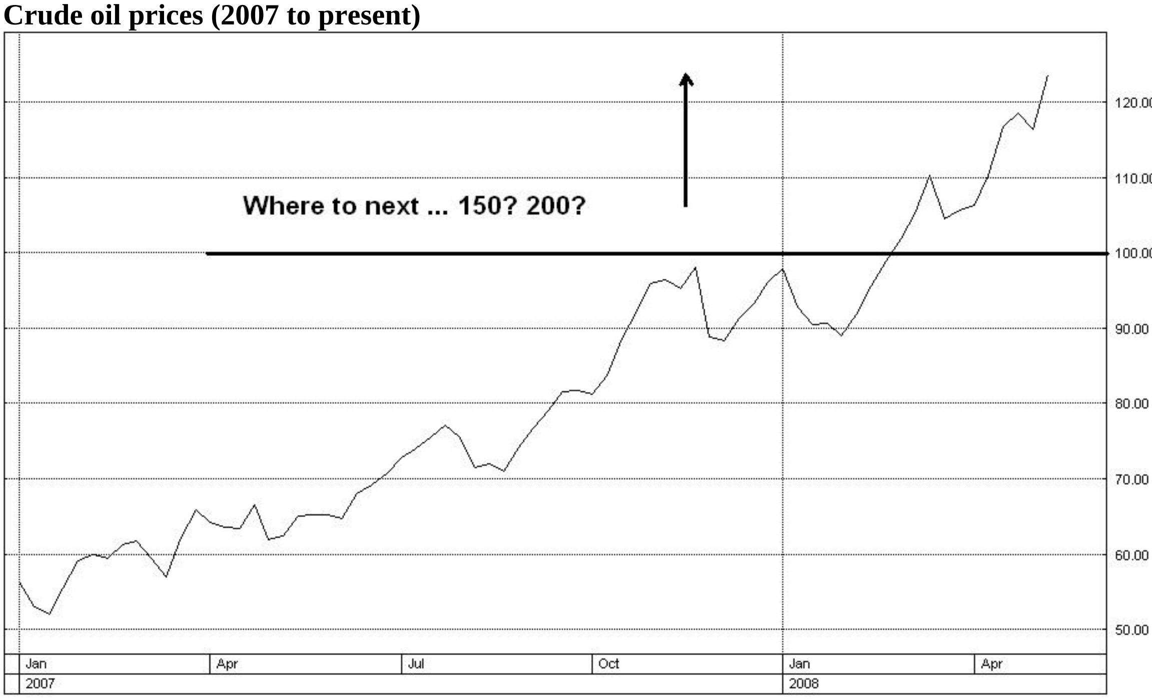
Back in 2005, when oil was still trading between $40 and $50 per barrel, Goldman had predicted that oil may spike to as much as $100 a barrel before the end of the decade as part of its "super-spike" theory. People deemed the forecast to be over-the-top at that time but now it's already a reality. Even Goldman was caught off guard when oil went up that fast and exceeded their target without extraordinary geopolitical turmoil. Equally surprising is that oil prices continue to soar, even though the US appears to be in recession and global growth rate has slowed significantly.

There are far fewer skeptics now as Goldman sees oil averaging $95 per barrel for 2008, $105 per barrel for 2009 and $110 per barrel for 2010. However, in their May 5 research, Goldman hinted that oil prices could head even higher. They predict oil to top out at $150 to $200 per barrel within the next six to 24 months in case of a rebound in US GDP growth or a major oil supply disruption. This dire prediction alone was enough to push prices significantly above the $120 per barrel last week.

Magic Round numbers

But even before Goldman's latest oil report was released, investors have been pumping in more money to the oil market after it broke major resistance of $100 per barrel in February. With oil trading at new highs, there is no historical price resistance that would act as a ceiling. The next resistance, therefore, would be the next significant round number. This explains the acceleration in price after $100 was broken.

Crude oil prices (2007 to present)



Source: Technistock

In technical analysis, one hears a lot about support and resistance levels. Basically, they are points in the chart where the probabilities favor at least a temporary halt in the prevailing trend. Often, support and resistance levels for markets can be determined by "psychological" price levels. These are usually round numbers that are very significant in a market. For the Dow in the 1970s, it was 1,000. In the 1990s, it was 10,000.

For oil during the last four years, it was $50, then $100. Now, the magic number has been raised to $150 and possibly $200.

Is oil price stability a wishful thinking?

We have noted before (see *"Oil on the way to $100"* in the October 29, 2007 issue of **The Philippine Star**) that several factors are contributing to the crude oil rally. These are the following:

1) Rising crude oil demand, especially from China and India, against a backdrop of tight supply conditions.
2) Political tensions in the Middle East and supply disruptions in Iran and Nigeria.
3) Weakening US dollar
4) Prevalence of financial products and derivatives related to oil such as the United States Oil Fund (symbol:USO).

Moreover, OPEC seems to be testing the global demand curve. It is appalling that OPEC refuses to increase production, even at a time when oil prices are at triple digits. This has also raised doubts as to whether OPEC has the capability of increasing its output, even if it wants to.

Nevertheless, we are optimistic that some normality in the crude oil market would return soon. There are now clear signs that the global economy is slowing and oil demand should soften somewhat going forward. In addition, with the Fed likely near the end of its easing stance, the "monetary push" on oil prices should taper off as well. Meanwhile, the US dollar is returning to a period of stability as economic weakness rotates into other G7 nations. This should remove another stimulating factor for oil prices.

Taking advantage of our natural resources

Longer term, the picture is less clear. A commodities mania is well underway and oil is a clear candidate for mass speculation. The problem is that commodities in general, and oil in particular, are tangible assets, and their price gains always have real economic consequences.

It is a good thing, however, that the Philippines is blessed with natural resources (minerals & renewable energy sources). The government, therefore, should be more proactive in implementing policies that encourage the exploration, development and production of these natural resources. It is also imperative that the government look for long-term energy solutions. The introduction of incentives for the use of biofuels and the development of mass transportation, for example, are most welcome.

In this period of high oil prices, we must make full use of our own natural resources. At the same time, we must reduce our energy demands by promoting energy sufficiency. Failing to act now will likely result in greater economic damage over the long-term.

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