Infomail

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CRUDE MOVE

A drop in the bucket or a game changer?

The International Energy Agency (IEA) yesterday announced it would release a total of 60 million barrels of oil in an attempt to add liquidity to the oil market ahead of what is expected to be rising refinery demand during the second half of 2011. It will be 2 million barrels a day for 30 days.

The IEA was formed in 1974 due to Oil Embargo in the early 1970's. It includes 28 members, mostly European nations along with South Korea, Japan…and the USA. Even though there are 28 members, half of the emergency oil being released comes from a single country…you guessed it…the USA.

The move seems to have initially backfired miserably as stock markets tumbled hard and fast, despite at one point a $5 a barrel drop in oil prices.

This move is being talked up as a stimulus plan, but I think it's more of a bailout plan…for Europe and for the President. If governments in the USA and Europe were serious about oil prices, they would be making massive pushes for exploration and drilling, instead of inhibiting it. In the USA, onerous rules and regulations have prevented the building of new refineries for about four decades. In Europe, taxes are so high on energy that governments make more money from oil than any belligerent oil producing nation. All governments do well by oil taxes.

The Strategic Petroleum Reserve (SPR) in the US which was created for national security reasons, was at capacity at 727 million barrels, is the world's largest supply of emergency crude oil.

But what was the emergency at this time?

It is only the third time in history the SPR has been tapped. The last time by President Bush after Hurricane Katrina, but it was only 11 million barrels as a stop gap. Prior to that, President Clinton in September 2000 released 30 million barrels.

So if no emergency, one would have to say that this decision was entirely politically motivated. The timing seems more than coincidence, the day after the Fed makes comments how high energy prices are hurting economic recovery or two days after polls show President Obama's ratings at the lowest level since he was elected.

It remains to be seen how the impact of the IEA decision will turn out. After President Clinton's move in the fall of 2000, oil prices fell from about $37.50 to about $25.00 in 3 months.

This new phase of the last couple years of governments acting as "portfolio managers" to influence markets by various forms of intervention seems to be creating more uncertainty. Unless this phase becomes signalled as temporary, it will continue to alter the normal day to day functioning of financial markets and will create more volatility as well.

Stay Tuned,

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