BULLS AND BEARS

- $160 CRUDE, $10 GASOLINE
  - NOT VERY CREDIBLE
- $50-60 FOREVER
  - A NEW PARADIGM, SOARING DEMAND
- A $40 PLATEAU? OPEC’S DREAM(?)
- SUB-$20
  - POSSIBLE, BUT SO IS DEMOCRATIC IRAQ
- BACK TO $30: 1986 REVISITED

This is from my 2005 talk to the Houston chapter. Shockingly, my views haven’t changed much. (Note the qualifier).
Some have developed methods to deal with annoying forecasters. Roman Emperor Hadrian, after getting a prophecy from the Castalian fountain, had it bricked up. How many wish they could so the same?
People note the current level of prices, well below the peak, 
And anticipate a recovery to earlier prices.
Typical is the current US Dept of Energy forecast, which sees the price HITting $100 in the next few years, then continuing to rise.
Put in context however, it is clear that this is a rather extra-ordinary forecast.

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Marx once noted that Hegel believed that history always repeated itself. But he added that the first time was tragedy, the second farce.
TRAGEDY: 1980 PRICE FORECASTS

I worked on the IPE model and can now brag (sic) about my error of only 250%.
Five years ago, the same forecasters predicted long-term prices Under $30. Note that the SEER forecast is from my partner.
Jatropha (left) is touted as a source of a bean that can be used as biodiesel, grows in arid areas. In the 1970s, jojoba (right) was touted similarly.
PEOPLE OFTEN CITE THE RISE OF RESOURCE NATIONALISM AS A NEW ELEMENT IN THE CHANGED MARKET PARADIGM, BUT IN THE 1970S, TRUDEAU OF CANADA WAS LEADING THE EFFORT AGAINST FOREIGN OWNERSHIP OF HIS RESOURCES, AND RESTRAINING PRODUCTION FOR FUTURE GENERATIONS.
RECENTLY, JAMES SCHLESINGER ANNOUNCED THAT THE PEAK IN OIL PRODUCTION HAD ARRIVED. OF COURSE, HE SAID THE SAME IN 1979.
AND WE ONCE AGAIN HAVE A PRESIDENT WHO SUPPORTS NUCLEAR POWER.
From 1980 to 1985, the market weakened continuously. But prices only dropped slightly, and were more than twice the pre-1979 level.
PRICES TO SOON ‘RECOVER’
PRICE DOESN’T MATTER
- DEMAND DOWN BECAUSE OF RECESSION
- DEMAND RECOVERY IMMINENT
NON-OPEC HAS PEAKED
- NON-GULF PEAKED, EXCEPT MEXICO
- OPEC MULTIPLIER
  - (SEE ADELMAN)
COSTS SO HIGH, PRICES MUST RISE
- “Two experts...calculated that the daily capital cost per barrel of new production outside OPEC jumped from $3,000 to $70,000 between 1963 and 1982.” (1985)

THESE SAME ARGUMENTS ARE BEING MADE NOW.
BOTH THE FUNDAMENTALS AND GEOPOLITICAL FACTORS ARE MUCH MORE BEARISH.

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<tr>
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<tr>
<td><strong>STOCKS</strong></td>
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HIGH COSTS: CYCLE OR PERMANENT?

- RUN-UP VERY SUDDEN (LAST FEW YEARS)
- MUCH OF IT CYCLICAL
  - STEEL, CEMENT
  - HIGH ACTIVITY LEVELS
- MOST ESTIMATES INCLUDE TAXES
- COSTS RESPOND TO PRICES

RECENT RESEARCH AT SEER SUGGESTS THAT THE RUN-UP IN COSTS DURING THE PAST FEW YEARS WAS DUE TO CYCLICAL FACTORS, AND ARE NOT PERMANENT.
ALTHOUGH SOME HAVE ARGUED THAT PROJECT COSTS RUN AS HIGH AS $80 PER BARREL, THEY ARE INCLUDING TAXES. CAPITAL AND OPERATING COSTS, IN THIS INSTANCE, ARE BELOW $20.
STEEL PRICES MIGHT UP A LARGE COMPONENT OF HIGHER COSTS IN RECENT YEARS, BUT ARE CLEARLY CYCLICAL.
IT CAN BE SEEN THAT WELLS TEND TO GET DEEPER OVER TIME, A SIGN OF DEPLETION.
BUT OFFSETS

BUT THERE ARE OFFSETTING FACTORS, SUCH AS BETTER RIG EFFICIENCY.
SEER IS RELEASING A STUDY OF THE RECENT PLATEAU IN NON-OPEC PRODUCTION.
THE PAST DECADE, NON-OPEC, NON-FSU PRODUCTION HAS BEEN ABOUT 7 MB/D BELOW TRENDS.
This is not the first time that it has flattened out, but definitely the lengthiest.
BUT...

- NOT THE FIRST TIME
- TRANSIENT
  - 1998 PRICE COLLAPSE
  - OPENING OF FSU, VENEZUELA
    - 5 MB/D IN THOSE AREAS
  - LNG, SOLAR, ETC.
- TIPPING POINT IS HERE
- BACK TO A MARKET IN RELATIVE GLUT
  - ‘RELATIVE’ IS OPERATIVE WORD: NOT THE 1980S
COMPARED TO THE MID-1980S, THE MARKET IS NOT NEARLY AS WEAK.
ALTHOUGH THE LAST FEW MONTHS HAVE SEEN A SHARP DROP IN SAUDI SHARE WITHIN OPEC, PRIMARILY DUE TO THE RECESSION.
As in the 1990s, it appears that the socialist vision which has led to economic problems in countries like Argentina will again fall out of favor, improving economic performance.
IN THE OIL SECTOR, ESPECIALLY IF PRICES ARE LOW, A RETURN TO THE REFORM APPROACH OF LUIS GIUSTI SEEMS MORE LIKELY TO PREVAIL THAN THE NATIONALISTIC APPROACH OF HUGO CHAVEZ.
...could lead to this
(Venezuelan production)

With reform, Venezuela—long considered a mature province—experienced a serious production boom.
FUTURE MARKET
(PRIMARY SCENARIO)

- LIQUIDITY GOES AWAY, PRICES DROP
- IRAQ, NIGERIA ADD PRODUCTION
- DEMAND WEAK (1.2% GROWTH...?)
- NON-OPEC SOARS
  - NON-FSU ADDS 300 TB/D+/YR
  - FSU ADDS 200 TB/D+/YR
  - NGLS UP TO 500 TB/D/YR
- GLUT: PRICES DEPRESSED
  - LESS POLITICS (HUGO RETIRES TO CSIS?)
  - ECONOMIC BOOM (MILTON ROCKS!)
  - DEMAND GRADUALLY RECOVERS
OF COURSE...

- PRICE COLLAPSE COULD RESTART THE CYCLE
  - VENEZUELA, IRAN, NIGERIA AT RISK
- SURPLUS CAPACITY HIGH, BUT NOT THAT HIGH
- DEMAND BOOM MEETS WEAK SURPLUS CAPACITY AND SUPPLY DISRUPTION
- PEAK OIL INDUSTRY FLOURISHES!
INDUSTRY EXPECTATIONS

- **UPSTREAM:**
  - SMALL PLAYERS, SERVICE INDUSTRY CLOBBERED
  - BIG PROJECTS, DEEPWATER BETTER OFF

- **DOWNSTREAM:** HAVE THEY EVER WON?

- **HIGH COST PROJECTS DIE OFF**
  - LNG (NGLS), TAR SANDS
  - PV, ELECTRIC CARS, ETC. GONE BUT NOT FORGOTTEN
    - MICHAEL MOORE’S NEXT MOVIE

- **CONSUMERS WIN IF LUCKY, SUFFER VOLATILITY IF UNLUCKY**
  - VOLATILITY IS GOOD FOR CONSULTANTS AT LEAST