

Ryan Sharp

Are High Oil Prices Here to Stay?



Are you tired of paying more than a dollar a litre for gasoline? More important, why has the price of oil gone up so much and will it stay there?

Demand

Global Oil consumption averaged 82.1 million barrels a day in 2004 and is forecasted by the International Energy Agency to grow to 83.45 million barrels a day in 2005. The long-term forecast is for oil consumption to grow to 119 million barrels a day in the year 2025.

Why the large increases?

The United States is currently the largest consumer of oil in the world. The largest change in consumption over the last few years, however, has come from developing countries, particularly China. In 1993 China went from being a net exporter of oil to being a net importer of oil and consumption has grown ever since. China is now the world's second-largest net importer of oil. In 2004 consumption in China grew by 1 million barrels a day; China is forecast to be importing 10.9 million barrels a day by 2025.

Supply

The global supply of oil is open to many questions and possible disruptions. Most recently, Hurricane Katrina caused a major disruption to both short- and mid-term supply and refining capacity in the Gulf of Mexico. In 2003 the war in Iraq reduced production there by 2.3 million barrels a day. There have been a series of these temporary disruptions for years, usually causing oil prices to increase in the short term.

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What has changed?

Analysts are starting to forecast long-term demand outpacing long-term supply capacity. Prior to Hurricane Katrina, oil production was around 84.2 million barrels a day or slightly above current levels of demand. The fear driving oil prices higher is that we do not have enough excess capacity to meet growing global demand

or to compensate for another supply interruption.

Balance

With available supply roughly equal to the amount of demand in the market, the price of oil and oil products should reach a balance point. In other words the price of oil should reach a point where growth in demand slows enough to meet the growth in supply.

Are we at such a point? Already the demand for oil and oil products is showing signs of slowing with the growth in Chinese imports down significantly from last year.

Without another major disruption in the supply of oil, the higher prices should reduce demand enough in the short term to find a steady price point. In the long term, however, the growth in consumption from developing countries, especially China, could start to put pressure on oil supply and raise long-term prices if there is not a significant production increase.

Canada

The effect of high oil prices on Canada is both positive and negative. On the positive side, Canada is a net exporter of crude oil and the largest exporter in the world

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of crude oil and crude oil products to the United States. The average export is around 2.1 million barrels a day, accounting for almost 15 percent of the United States imports. In July, oil exports helped raise our trade surplus to \$5.8 billion. This in turn has helped to strengthen our dollar, which is now commonly referred to as the “petro loonie” or “petro dollar.” Over the longer term, the oil sands in Alberta contain the second-largest known oil reserves in the world next to Saudi Arabia.

The negative impact of high oil prices is that we are spending a larger portion of our income on oil and gas than on other products. The same is true for other countries. The result is that higher oil prices may slow global economic growth.

In doing so, it should also slow the demand for oil, keeping the supply and demand in balance for the near term, again assuming no major disruptions in supply. Over the long term, I think we should get used to paying over a dollar a litre for gasoline. ▲

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