



Oil: The Headline Commodity

Oil prices have been volatile throughout the month of March responding to Middle East unrest, Japan and economic indicators. Oil prices then jumped to their highest levels in two and half years at the close of the month breaching \$117 bbl with supply concerns the driving factor. So with the oil markets seemingly responding to headline news developments, is there really any fundamental analysis driving the oil prices gains?

The state of play in the Middle East and North Africa (MENA) set the tone for the oil markets at the start of the March 2011 with the uncertainty creating a bullish air. The earthquake was a game changer though and oil was one of the few commodities to suffer losses as traders priced in the anticipated drop off in oil demand in Japan. However strength soon returned as the focus again switched to MENA with supposed ceasefires and on going air strikes in Libya coupled with the Palestinian rocket attacks against Israel. Eurozone debt concerns then provided the bearish sentiment amidst speculation at the time that Portugal would become the third Eurozone country to request emergency aid. Supply concerns then pushed oil its highest level at the close of the month as the uprising in Libya looked more like a stand off with little sign of resolution on the horizon. A key oil region in the east of Libya changed hands four times in 3 weeks, and output remained at a near standstill compared to 1.69million barrels a day before the unrest.

So is there more to this headline driven commodity at the moment?

When it comes to the 'Supply' element of the equation, the oil analysts are really focusing on MENA at the moment and little surprise considering that 11 of the 18 countries in MENA are oil exporters supplying 57% of oil flows into Asia, Europe and North America. The loss of production in Libya accounts for 6% of MENA exports.

The real issue lies in the fact that the crisis in this region was unanticipated and the full impact is still unfolding. The events represent history in the making and therefore the outcome is difficult to predict. Perhaps what is certain is that the political landscape for the MENA region will be fundamentally different. When the Iron Curtain came down in 1989, just 2 countries within the Eastern European territory retained communist status and so, with this in mind, the oil markets are anticipating further regime changes within the MENA region. Of course further regime changes may not result in the breakdowns that have been seen in Libya, but the risk of supplies being affected certainly increases.

On the 'demand' front, the markets are still forecasting oil demand growth particularly in emerging markets where fast paced economic growth has been seen including Brazil, China as well as smaller economies in Easter Europe, Latin America and Asia. Economic growth creates demand for transport oils (diesel and jet fuels) and global car sales are expected to rise (with its resultant impact on gasoline use - 9million barrels/day in the US).

So given all of this, something has to give. With threats to oil supplies still looking precarious then demand will have to be curbed - but at what price? Who knows? But expect oil markets to remain volatile and bullish in the coming months.