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Article — Digitized Version

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Intereconomics

Suggested Citation: Hamburg Institute of International Economics (HWWA) (Ed.) (1989) : Ample supply in the world oil market, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 24, Iss. 5, pp. 255-256,
<https://doi.org/10.1007/BF02928643>

This Version is available at:

<https://hdl.handle.net/10419/140207>

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Ample Supply in the World Oil Market

A major contributory factor to the faster upsurge in prices worldwide since last autumn has been the increase in the cost of oil. After having fallen by October 1988 to US\$ 12/barrel, the spot price for North Sea Oil (Brent) had gone up by more than 50% by April 1989 and despite the decline since it was still higher in mid-September than in last autumn at US\$ 18/barrel. On the whole though, the price fluctuations have kept within the margin typical of trends since the price collapse in the spring of 1986. The quotations on the world market are thus well under OPEC's target, considering that its reference price of US\$ 18/barrel relates to sorts of oil which average US\$ 1 to US\$ 2 less than Brent oil.

The pronounced fluctuations in oil prices over recent years have been triggered in particular by temporary changes in supply. The price drop up to autumn 1988 for example was the result of a rapid rise in output in the OPEC countries. The ensuing price increase was caused by a renewed agreement on production quotas within OPEC, joined by non-member states announcing cuts in oil exports. Another factor was the stoppages on oil rigs in the North Sea. As with previous agreements, major OPEC countries relaxed their quota discipline again quickly as oil prices rose substantially. Even after the agreed aggregate production was set higher at 19.5 million barrels a day in June, actual supply is estimated to have exceeded this figure by roughly a tenth. Kuwait and the United Arab Emirates in particular overstepped their quotas appreciably. Added to this, North Sea production began to pick up again after the stoppages.

Given this supply trend, it is remarkable that oil prices receded only gradually after their last high in April. The crucial determinant here was the sustained rapid growth in demand. As early as last year, world oil consumption (excluding state-trading nations) expanded much more vigorously than expected at 3%, with stock replenishment turning out to be below estimates. Apart from cyclical impulses, the price collapse of 1986 boosted oil consumption. Also, it emerged that – even

for earlier years – the oil used in the developing countries had not been fully recorded; particularly in Asian countries, it went up faster than expected. In all, oil consumption in the OECD countries rose by nearly 3% in 1988 and in the developing countries by 4.5%. According to the latest forecasts of the International Energy Agency, the increase in the OECD countries will decline by almost one-half in the course of this year, although this decline will be exaggerated by special factors, such as pre-emptive buying of fuel oil before mineral-oil taxes rose. With virtually unaltered consumption growth in the developing countries, world oil consumption is expected to rise by 2.5% in 1989, thus almost reaching the record level of 1979, although consumption in the OECD countries is still some 10% less than it was then.

Production trends will continue to exert a major influence on prices. It may be expected that, the technical problems having been dealt with, production in the North Sea will at first be stepped up further. Although this will be attended by a seasonal resurgence in demand on the world market, heavier supply pressure can only be avoided if OPEC curbs its production more effectively than in recent months. The continuing expansion of production and transport capacity in major countries – partially due to the repairing of plant damaged during the Gulf war – will certainly make the implementation of such a policy more difficult. Besides, Saudi Arabia is no longer prepared to perform a balancing role as “swing producer”. Based on the experience of recent years, restraint can only be expected from the OPEC members when prices are on the decline, while higher prices will stimulate additional supply. Under these circumstances, further sizable short-term price fluctuations are to be expected while the basic trend is likely to remain fairly steady.

While in the short term OPEC will probably not be able to attain its price targets for any length of time, in the longer term conditions will be more conducive to greater market power, particularly because, according to figures

ECONOMIC TRENDS

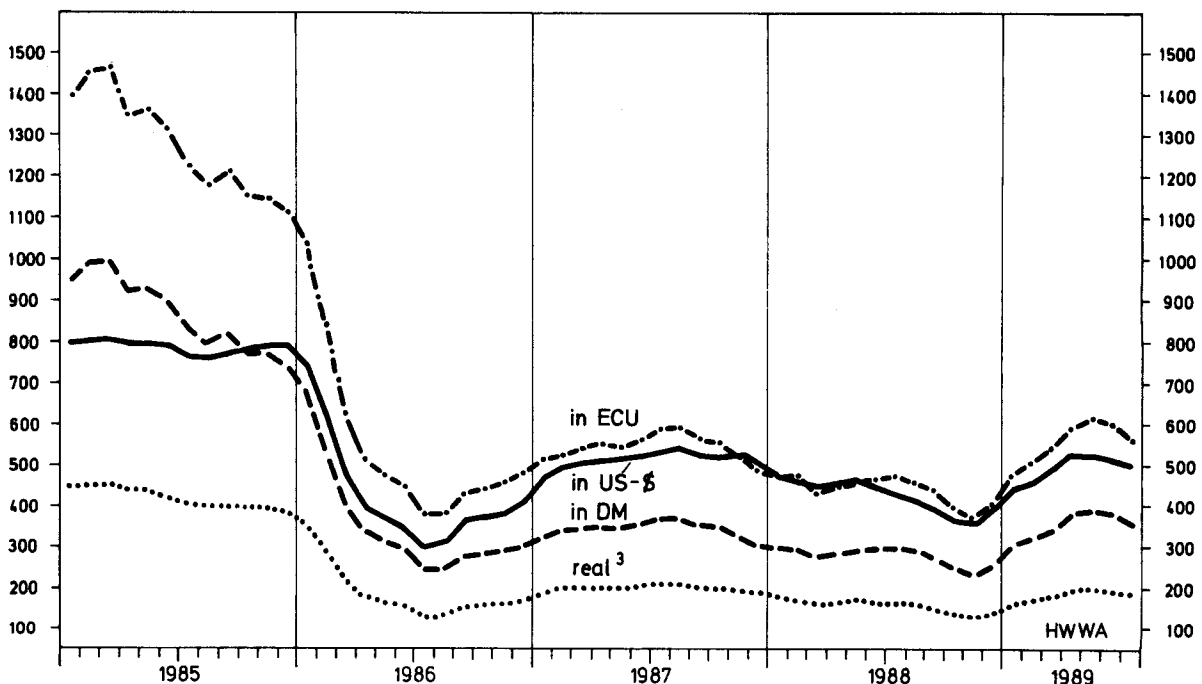
for the beginning of this year, OPEC members have more than three-quarters of proven world reserves at their disposal, the countries of the Near East alone over two-thirds. The relatively costly development of oil deposits outside OPEC has also been retarded by the price collapse in 1986, as is particularly evident in the USA. Dwindling earnings have however led to increased efforts to cut costs for exploration, development and production, so as to postpone the – ultimately inevitable – decline in total production outside the OPEC. The conservation and substitution processes instigated by

the oil price hikes in the past are still affecting consumption, and environmental policy objectives are pointing ever more clearly in the same direction, but the appreciably lower oil prices since the beginning of 1986 are certain to spur demand. All in all, it is still impossible to tell when the demand/supply situation on the world oil market will again consistently favour the producers.

*Compiled by the Department of World Business
Trends of the HWWA-Institut für Wirtschaftsforschung-
Hamburg.*

Price Trends in Crude Oil¹ 1985-1989

Monthly average², 1973 = 100



¹ Average import price of OECD countries. ² Estimated as of June 1989. ³ Related to the average price of industrial goods exports of the industrialized countries.

Source: Calculations based on OECD and UN figures.

HWWA Index of World Market Prices of Raw Materials¹

(1975=100)

Raw Materials and Groups of Materials	1988		1989					
	AA ²	August	May	June	July	August	25. 8.	8. 9.
Total index ^P	143.4	140.4	159.3	155.9	156.3	151.8	152.6	155.6
Total, excl. energy raw materials	150.2	159.5	153.3	148.6	147.2	146.6	148.1	145.0
Food, tropical beverages	108.6	112.0	111.1	108.0	102.7	96.7	95.7	96.7
Industrial raw materials	181.8	178.1	185.4	179.5	181.1	184.6	188.0	181.8
Agricultural raw materials	191.6	192.4	187.8	185.5	189.8	191.6	190.7	188.6
Non-ferrous metals	216.4	205.3	225.6	209.3	205.6	219.8	233.8	220.4
Energy raw materials ^P	139.5	135.2	162.9	160.2	161.6	154.8	155.2	161.8

¹ On dollar basis. ² Annual Average. ^P Provisional (due to incomplete data on oil prices).