



## Oil Report

Phone 1300 660 734  
www.commoditybroking.com.au

18th August 2009

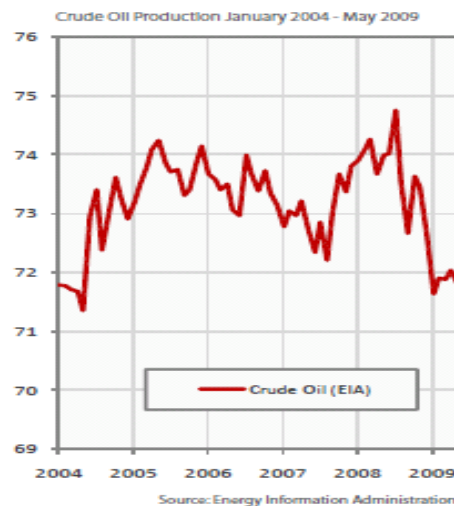
### Oil – What are the fundamentals saying?

Oil looks to be marking time with recent daily trading being restricted to moribund ranges. After so far gaining 88% in the last six months traders are sifting through the news looking for a direction. The level of optimism for a global economic recovery continues to swell with recent better than expected Unemployment statistics in the US and Japan's GDP expanding by 3.7% in the last quarter, the first in five months, all suggests the optimism is justifiable. The announcement by the EIA that it would continue the trend of the last 2 reports to see a further increase in its projections for global demand to 83.85 million bpd is backed by continual increases from OPEC and the IEA, which reiterated the EIA call. **All very positive news yet for some reason Nymex Crude has failed to breach resistance at US73.38 made at the end of June when equity markets started to rally. Why?**

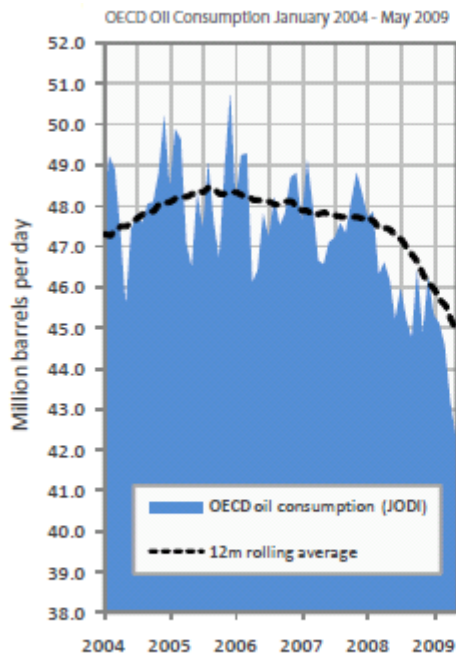
Understandably, we are dealing with optimism of a global economic recovery however this optimism has failed to spill over into the Crude market. This renewed confidence on the outlook for demand has not lead to higher prices for crude. If the demand scenarios are finding it hard to motivate the price for crude then it must be the supply factors holding it back. In this brief we look at the supply factors current in the market and suggest that a correction is under way.

### Global supply for crude

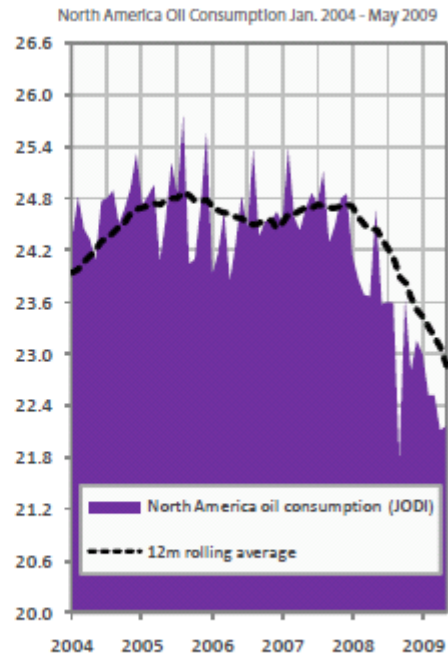
It was interesting listening when OPEC this month predicated that the price of Oil would fall unless there was more indication that the world economy would pick up. This is a change in rhetoric from the cartel and perhaps a little more realistic as to the current market condition. Weekly data in the US on inventories are continuing to show signs that consumption is not keeping up with production. It can be argued that higher prices, not just for OPEC, but perhaps for the rest of the world are better for economic stability rather than prices at US55.00. However, are the current prices warranted? It is without doubt that the GFC has caused a slowdown in consumption and production. This can be easily seen from the Global Production chart below, which shows a major drop in production to levels not seen since 2004. In round figures production has dropped off by 4% from its highs in mid 2008.



However, in comparison to production, consumption has dropped off significantly more. In both the OECD and North America we can see that consumption between mid 2008 and today has dropped off by 7.6% for OECD nations and 6.9% for North America.

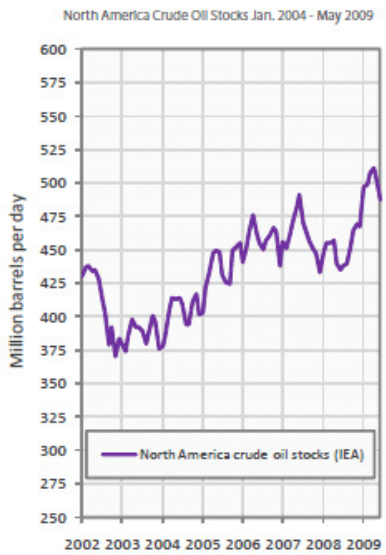


Source: Joint Oil Data Initiative

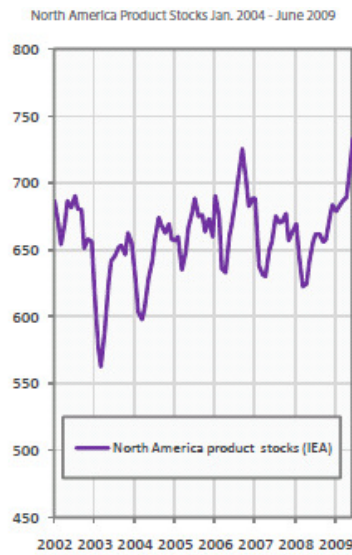


Source: Joint Oil Data Initiative

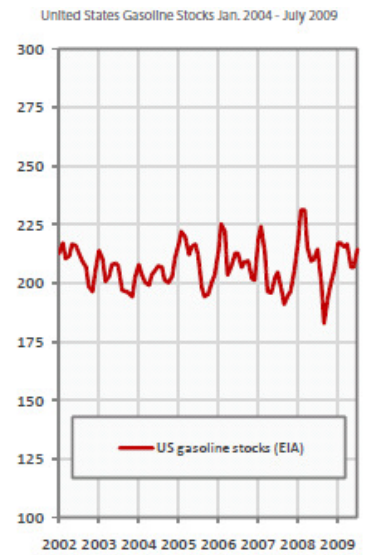
This suggests that we continue to produce more than what is consumed. **An Oil glut...interesting thought?** Weekly products data in North America continues to show builds. In most products stocks are above the 5 year average. The data below shows the increasing stocks of Crude and Products have been climbing regardless of the GFC .



Source: International Energy Agency



Source: International Energy Agency



Source: Energy Information Administration

So if consumption fails to keep up with production, as is indicated above, then stocks will build until economic activity picks up or production drops off significantly. As stocks build, price pressures to the upside eases and so prices will adjust downwards. **So to reiterate OPECS fears, if economic activity doesn't pick up then the price of Crude will probably come under pressure.**

**But what about China?** It is agreed that China's consumption continues to climb and that many suggest that the country's economic growth may placate the drop of in demand from other countries; however this is not the case. Average Oil consumption per day in China in 2009 up to May was 6.98mmbpd versus 6.92 and 7.29 mmbpd in 2008 and 2007. In 2008 the US was consuming 21mmbpd so North America remains the dominate force in consumption. So China

would need to double consumption if it was going to make up the difference in that consumption lost in the US.

**Does the technical picture suggest the same?** Technically, we have failed to push through resistance at US73.50 and with momentum indicators turned and heading lower can suggest that prices will remain soft for a while. The key to the longevity of the move is the test of support at US65.00. As can be seen this represents trend line support from the low of US33.57 made February this year. A break of this trend line support suggests prices can come back to US 60.00 then if pushed US55.00 is just around the corner. Stops on any positions at the moment have to go in US75.70.



Our view has been to build a case in favor of a move lower in the short term, however, after trading the crude market for many years and with the prospects of it trending higher over time we can suggest that if we get a shift lower that it is only a temporary fix. A bear move in an overall bull market. In doing so it is always prudent if looking to go short to have a trailing stop and further a stop and reverse on any bearish strategy.

Happy Trading

Jonathan Barratt

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