This Week in Petroleum 10-31-07

Posted by Robert Rapier on October 31, 2007 - 11:00am
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Halloween Edition - Updated following the release of the report

Overall inventories decreased, and there was a fairly large crude draw, which is likely to push oil prices up from here. If the Fed cuts rates by 0.5%, then I would say we have a decent chance of $100 within the week. No rate cut, and prices probably fall back. (ED: See Khebab's post above for related charts.)

> U.S. commercial crude oil inventories (excluding those in the Strategic Petroleum Reserve) fell by 3.9 million barrels compared to the previous week. At 312.7 million barrels, U.S. crude oil inventories are in the upper half of the average range for this time of year. Total motor gasoline inventories increased by 1.3 million barrels last week, and are in the lower half of the average range. Both finished gasoline inventories and gasoline blending components rose last week. Distillate fuel inventories increased by 0.8 million barrels, and are at the upper limit of the average range for this time of year. Propane/propylene inventories increased 0.9 million barrels last week. Total commercial petroleum inventories decreased by 1.1 million barrels last week, but are in the upper half of the average range for this time of year.

Crude imports were up over last week (which isn't saying much, as last week's imports were very low). Gasoline imports were very healthy for this time of year, which is surprising to me because of the weak dollar, and the current level of crack spreads:

> U.S. crude oil imports averaged nearly 9.4 million barrels per day last week, up 278,000 barrels per day from the previous week. Over the last four weeks, crude oil imports have averaged nearly 9.7 million barrels per day, or 481,000 barrels per day less than averaged over the same four-week period last year. Total motor gasoline imports (including both finished gasoline and gasoline blending components)last week averaged 1,238,000 barrels per day. Distillate fuel imports averaged 325,000 barrels per day last week.

Refinery utilization slid again this week. Refineries should be coming out of turnarounds at this point, but low crack spreads are a disincentive for refiners to work around the clock and spend extra money to expedite returning to full capacity. Also, as the crack spreads decline, there are marginal barrels that you will simply be unwilling to purchase, as they will essentially take your marginal crack to zero. Refiners have models that predict things like this, and I have seen lots of cases in which barrels were available, but refiners chose to run at less than capacity rather than earn nothing on the additional barrels they would have to purchase to come up to full capacity. And I have first hand knowledge that this is indeed the case at some specific refineries.

> U.S. crude oil refinery inputs averaged 14.9 million barrels per day during the week ending October 26, down 13,000 barrels per day from the previous week's average. Refineries operated at 86.2 percent of their operable capacity last week. Gasoline production fell compared to the previous week, averaging 8.9 million barrels per day. Distillate fuel production rose last week, averaging 4.1 million barrels per day.

Note also the seasonal shift toward distillates.

Finally, I continue to see conflicting reports on whether gasoline demand is up or down:

> Total products supplied over the last four-week period has averaged 20.7 million barrels per day, down by 0.1 percent compared to the similar period last year. Over the last four weeks, motor gasoline demand has averaged nearly 9.3 million barrels per day, or 0.3 percent above the same period last year.

At this point, I think the Fed will make the final determination on whether we reach $100 within the next week.

Halloween Edition - to be updated following the release of the report

Yogi Berra once famously noted "*It's tough to make predictions, especially about the future*."

I will add a corollary to that, albeit without Yogi's succinctness: *As a future event becomes more probable, the number of people who knew it all along will grow exponentially*. I mean, let's face it. Wasn't if obvious that Boston would win the World Series? Likewise, wasn't it obvious that crude prices would be knocking on the door of $100 as November approached?

I want to review, because I see a widespread affliction of amnesia following this recent 30% run-up. Flashback to August. Oil prices were poised to go on a run that would take them to over $90 in October. What were people saying then? It was in August that legendary oil man T. Boone Pickens told CNBC; "I think you're going to see $80 a barrel before I'm 80." His 80th birthday is in May 2008. CIBC World Markets said that crude prices could reach $80 a barrel this year and $100 by the end of 2008. Deutsche Bank raised its "long-term" oil price forecast to $60 a barrel. And the EIA wrote in their August Short Term Energy Outlook: "Crude oil prices, which have been rising over the last 2 months, are expected to reach a peak monthly average price in August before starting to ease slightly."

That was conventional wisdom. Some were calling for lower oil prices, and those calling for higher oil prices certainly were not calling for $100 oil in 2007. That was what the talking heads and the analysts were saying in August. One notable exception was Goldman Sachs, who wrote that US crude price could top $90 a barrel in the fall and hit $95 by the end of the year if OPEC didn't bump production. They nailed it. But their opinion was definitely not held by the majority as if it was obvious all along.

On the topic of Goldman Sachs, I have seen some suggest that they are trying to influence oil prices by telling clients to take profits. Of course one wonders if the same people were making those claims when oil was $70 and Goldman was calling for it to run to $90. I guess if you are long at $93, Goldman says take profits, and you start to lose money, it's not that you misjudged. No, it's market-manipulation. But that works both ways. And the U.S. Commodity Futures Trading Commission has noted that the long to short ratio has grown rapidly throughout this rise. That in and of itself will help fuel the climb. But this Goldman Sachs issue is a good example of why I don't trade short-term. The fundamentals in the short-term can be wiped out by market sentiment. And things like their sell recommendation can swiftly change market sentiment.

Anticipating Today's Inventory Report

As I wrote after the release of last week's report, "*this inventory report will provide a lot of fuel for the bulls for another week*." A lot of fuel indeed, as oil ran up by about 10% in the past week, before correcting back yesterday. So, do we get tricks or treats today? Of course one man's trick is another man's treat. And this week's inventory report will have lots of implications, as did last week's.

If we see a big draw, I think we see another run at $100. A big build, and the profit-taking continues. However, complicating today's report is the decision by the Fed whether to cut interest rates. If the Fed cuts rates by half a percent, and we see a big draw, I think we see $100 oil within a week. If the cut is a quarter point or no cut at all, I think we continue to see profit-taking unless there is a very big crude draw. No cut and a big build should cause prices to fall quickly. Of all the scenarios, I think the case for a sprint toward $100 is the weakest. My own thoughts are that we see a build* and a quarter point cut or less, and that oil prices slowly drift down in the short-term.

Personally, I wouldn't cut rates at all after the battering the dollar took the last time rates were cut. But they didn't ask my opinion. Nor, as far as I can tell, did the Fed read my blog to find out my opinion. But as I noted yesterday, someone at Goldman Sachs did. So I take full responsibility for manipulating the worldwide price of oil downward to avoid losing my $1,000 bet. :-)

***Note 1**: If I was running a refinery, I would probably prefer to pull down inventories with crude at these prices. You have probably seen the comments from major oil company executives who don't feel that the current price is sustainable short-term. If you believe a correction is coming, you may prefer to draw down inventories somewhat and take your chances. But as I have noted previously, that can be a Catch-22. Keep your inventories full at these prices, and you are supporting the current price levels. Pull them down in the current atmosphere, and you support the impression that supply is insufficient, which will favor higher prices.

Note 2: I won't be responding to comments on this essay, as I have pumpkins to carve and kids to take Trick-or-Treating.