Listening to the cacophony and trying to make some sense

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Everybody seems to have an opinion about where oil prices are headed and a rationalization for their prognostication. Lee Raymond at Exxon keeps jawboning for $25/bbl oil. John Browne at BP suggests oil prices will "settle" at around $40/bbl. OPEC's acting secretary general recently stated that OPEC's target price is between $40 and $50 (Petroleum Intelligence Weekly, Nov. 21 edition - requires paid subscription.) Oil pundits working for consulting companies, investment banks, the EIA etc. are predicting 2006 prices of about $58/bbl (average of 11 estimates ranging from $70 to $47/bbl - published in the Petroleum Intelligence Weekly Nov 14 edition.) The NYMEX futures market is "predicting" $60 to $61 through 2007, with prices in the mid-$50's out through 2012. Matt Simmons, on the other hand, made a $5000 bet that oil will be higher than $200/bbl by 2010.

Whose prediction is closer to the truth (as we know it today)? What are these people's motivations?

First of all, let's look at the oil companies. The leaders of BP and Exxon have complex roles here. They know that if they publicly state that oil is going to go to $100/bbl or higher, there will be world-wide consequences. I suspect that they have had numerous conferences with the US government, the British government, and other heads of state and have more or less got all their talking points together. Everything is fine. No reason to panic. Keep shopping. Keep buying cars. The world is not changing, etc. etc.

I also suspect (at the risk of being called part of the tinfoil-hat crowd) that a large part of the reason that our Veep Mr. Cheney (and President Bush) is so adamant about the need to stay the course in Iraq is that he wants our army smack-dab in the middle of Oil Country when the price goes through the roof. Keeping the oil flowing west will become a major foreign-policy goal of the US (as if it is not already).

Ultimately you cannot believe what these two CEO's (Browne and Raymond) are saying to the public about the price of oil. They will never tell you what they really think. They have numerous responsibilities, but their main jobs are to make money for their shareholders (and keep themselves in power). No part of their job descriptions involves leveling with the public.

What about the pundits? These guys, for the most part, are a big herd of sheep. It is no coincidence that the average of their predictions is almost identical to what the futures market is saying. These guys are deeply entrenched in the business community, and they sell services for a living. If they come out with radical predictions, businesses who buy their services will steer clear of them.

How about the futures market itself? The futures market is a very good tool for gauging where prices are headed in the near term. Traders are very good at absorbing the near term supply and demand data and translating that into a price. Beyond 6 months (3 months?) however, the predictive power of the futures market is poor, IMHO. The futures market tends to predict a continuation of the status quo, unless a clear reason for a future change is evident. For example, between March and April of 2006 the futures price for natural gas drops from $13/mmbtu to $10.6/mmbtu. This is, of course, because a highly predictable drop in demand for natural gas as warmer weather arrives.

Long term oil contracts are bought and sold by people mainly interested in securing long-term sales contracts or long-term supply contracts at known prices so that price risk in a particular venture is minimized. The people/companies who are engaging in long term hedging are doing this, not because they are trying to predict the future price, but because they can "lock in" the profit of a particular risky venture by locking in a long-term price. If a mid-size independent can lock in a price for a particular deepwater venture at a price that guarantees a 20% rate of return, he will do that because it meets his investment hurdle, not because he thinks the price will be higher or lower than that in the future. It basically allows him to go home and sleep at night and take his family on a vacation to the Bahamas without worrying about whether the price of oil will go up or down, completely out of his control, and cause him to lose his job.

What about OPEC? First of all OPEC is comprised of a consortium of countries that have little in common except that they have oil to sell. Each of these countries has it's own agenda. Clearly Venezuela's agenda is different than Iraq's agenda, is different than Saudi Arabia's agenda. However, all of them are primarily interested in maximizing cash flow to their individual countries. So the main goal of OPEC is to keep the price for oil as high as possible without causing either demand destruction worldwide or causing the US government to get concerned enough that it starts moving its troops from Iraq into the already-established military bases in Saudi Arabia. OPEC, like you and I, can look back over the last couple of years and see that the world can easily absorb $40 to $50/bbl oil without causing either of the two negative reactions above. Consequently, that is their new target price.

Lastly we come to Mr. Simmons prediction. The reason why I post here is that I, like most of you, are believers in the near-term onset of Peak Oil. I must admit I am a little perplexed by what has happened to oil and gasoline prices since Katrina. As a large chunk of the oil (and natural gas) from the GOM is still shut in, and the price was going up even before Katrina, I am wondering why the steep decline of price in the teeth of a significant drop in supply. Presumably, before Katrina there was a very tight supply-demand balance. If you take almost [1 MMBOPD out of the supply chain] shouldn't that have the opposite effect. I mean, how much oil was released out of the SPR?

Ultimately, I think Mr. Simmons will be closer than any of these other predictions. Will the price be more than $200 in 5 years. I sure hope not. I fear for the future of our planet and my children if it does.