More on the real reason behind high oil prices

Part II

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As detailed in an earlier article, a conservative calculation is that at least 60% of today's $128 per barrel price of crude oil comes from unregulated futures speculation by hedge funds, banks and financial groups using the London ICE Futures and New York NYMEX futures exchanges and uncontrolled inter-bank or Over-The-Counter trading to avoid scrutiny. US margin rules of the government's Commodity Futures Trading Commission allow speculators to buy a crude oil futures contract on the Nymex, by having to pay only 6% of the value of the contract. At today's price of $128 per barrel, that means a futures trader only has to put up about $8 for every barrel. He borrows the other $120. This extreme "leverage" of 16 to 1 helps drive prices to wildly unrealistic levels and offset bank losses in sub-prime and other disasters at the expense of the overall population.

The hoax of Peak Oil—namely the argument that the oil production has hit the point where more than half all reserves have been used and the world is on the downslope of oil at cheap price and abundant quantity—has enabled this costly fraud to continue since the invasion of Iraq in 2003 with the help of key banks, oil traders and big oil majors. Washington is trying to shift blame, as always, to Arab OPEC producers. The problem is not a lack of crude oil supply. In fact the world is in over-supply now. Yet the price climbs relentlessly higher. Why? The answer lies in what are clearly deliberate US government policies that permit the unbridled oil price manipulations.

World Oil Demand Flat, Prices Boom…

The chief market strategist for one of the world's leading oil industry banks, David Kelly, of J.P. Morgan Funds, recently admitted something telling to the Washington Post, "One of the things I think is very important to realize is that the growth in the world oil consumption is not that strong."

One of the stories used to support the oil futures speculators is the allegation that China's oil import thirst is exploding out of control, driving shortages in the supply-demand equilibrium. The facts do not support the China demand thesis however.

The US Government's Energy Information Administration (EIA) in its most recent monthly Short Term Energy Outlook report, concluded that US oil demand is expected to decline by 190,000 b/d in 2008. That is mainly owing to the deepening economic recession. Chinese consumption, the EIA says, far from exploding, is expected to rise this year by only 400,000 barrels a day. That is hardly the "surging oil demand" blamed on China in the media. Last year China imported 3.2 million barrels per day, and its estimated usage was around 7 million b/d total. The US, by contrast, consumes around 20.7 million b/d.

That means the key oil consuming nation, the USA, is experiencing a significant drop in demand. China, which consumes only a third of the oil the US does, will see a minor rise in import demand compared with the total daily world oil output of some 84 million barrels, less than half of a percent of the total demand.

The Organization of the Petroleum Exporting Countries (OPEC) has its 2008 global oil demand growth forecast unchanged at 1.2 mm bpd, as slowing economic growth in the industrialised world is offset by slightly growing consumption in developing nations. OPEC predicts global oil demand in 2008 will average 87 million bpd — largely unchanged from its previous estimate. Demand from China, the Middle East, India, and Latin America — is forecast to be stronger but the EU and North American demand will be lower.

So the world's largest oil consumer faces a sharp decline in consumption, a decline that will worsen as the housing and related economic effects of the US securitization crisis in finance de-leverages. The price in normal open or transparent markets would presumably be falling not rising. No supply crisis justifies the way the world's oil is being priced today.

Big new oil fields coming online

Not only is there no supply crisis to justify such a price bubble. There are several giant new oil fields due to begin production over the course of 2008 to further add to supply.

The world's single largest oil producer, Saudi Arabia is finalizing plans to boost drilling activity by a third and increase investments by 40 %. Saudi Aramco's plan, which runs from 2009 to 2013, is expected to be approved by the company's board and the Oil Ministry this month. The Kingdom is in the midst of a $ 50 billion oil production expansion plan to meet growing demand in Asia and other emerging markets. The Kingdom is expected to boost its pumping capacity to a total of 12.5 mm bpd by next year, up about 11 % from current capacity of 11.3 mm bpd.

In April this year Saudi Arabia's Khursaniyah oilfield began pumping and will soon add another 500,000 bpd to world oil supply of high grade Arabian Light crude. As well, another Saudi expansion project, the Khurais oilfield development, is the largest of Saudi Aramco projects that will boost the production capacity of Saudi oilfields from 11.3 million bpd to 12.5 million bpd by 2009. Khurais is planned to add another 1.2 million bpd of high-quality Arabian light crude to Saudi Arabia's export capacity.

Brazil's Petrobras is in the early phase of exploiting what it estimates are newly confirmed oil reserves offshore in its Tupi field that could be as great or greater than the North Sea. Petrobras, says the new ultra-deep Tupi field could hold as much as 8 billion barrels of recoverable light crude. When online in a few years it is expected to put Brazil among the world's "top 10" oil producers, between those of Nigeria and those of Venezuela.

In the United States, aside from rumors that the big oil companies have been deliberately sitting on vast new reserves in Alaska for fear that the prices of recent years would plunge on over-supply, the US Geological Survey (USGS) recently issued a report that confirmed major new oil reserves in an area called the Bakken, which stretches across North Dakota, Montana and south-eastern Saskatchewan. The USGS estimates up to 3.65 billion barrels of oil in the Bakken.

These are just several confirmations of large new oil reserves to be exploited. Iraq, where the Anglo-American Big Four oil majors are salivating to get their hands on the unexplored fields, is believed to hold oil reserves second only to Saudi Arabia. Much of the world has yet to be explored for oil. At prices above $60 a barrel huge new potentials become economic. The major problem faced by Big Oil is not finding replacement oil but keeping the lid on world oil finds in order to maintain present exorbitant prices. Here they have some help from Wall Street banks and the two major oil trade exchanges—NYMEX and London-Atlanta's ICE and ICE Futures.

Then why do prices still rise?

There is growing evidence that the recent speculative bubble in oil which has gone asymptotic since January is about to pop.

Late last month in Dallas Texas, according to one participant, the American Association of Petroleum Geologists held its annual conference where all the major oil executives and geologists were present. According to one participant, knowledgeable oil industry CEOs reached the consensus that "oil prices will likely soon drop dramatically and the long-term price increases will be in natural gas."

Just a few days earlier, Lehman Brothers, a Wall Street investment bank had said that the current oil price bubble was coming to an end. Michael Waldron, the bank's chief oil strategist, was quoted in Britain's Daily Telegraph on Apr. 24 saying, "Oil supply is outpacing demand growth. Inventories have been building since the beginning of the year."

In the US, stockpiles of oil climbed by almost 12 million barrels in April according to the May 7 EIA monthly report on inventory, up by nearly 33 million barrels since January. At the same time, MasterCard's May 7 US gasoline report showed that gas demand has fallen by 5.8%. And refiners are reducing their refining rates dramatically to adjust to the falling gasoline demand. They are now running at 85% of capacity, down from 89% a year ago, in a season when production is normally 95%. The refiners today are clearly trying to draw down gasoline inventories to bid gasoline prices up. 'It's the economy, stupid,' to paraphrase Bill Clinton's infamous 1992 election quip to daddy Bush. It's called economic recession.

The May 8 report from Oil Movements, a British company that tracks oil shipments worldwide, shows that oil in transit on the high seas is also quite strong. Almost every category of shipment is running higher than it was a year ago. The report notes that, "In the West, a big share of any oil stock building done this year has happened offshore, out of sight." Some industry insiders say the global oil industry from the activities and stocks of the Big Four to the true state of tanker and storage and liftings, is the most secretive industry in the world with the possible exception of the narcotics trade.

Goldman Sachs again in the middle

The oil price today, unlike twenty years ago, is determined behind closed doors in the trading rooms of giant financial institutions like Goldman Sachs, Morgan Stanley, JP Morgan Chase, Citigroup, Deutsche Bank or UBS. The key exchange in the game is the London ICE Futures Exchange (formerly the International Petroleum Exchange). ICE Futures is a wholly-owned subsidiary of the Atlanta Georgia International Commodities Exchange. ICE in Atlanta was founded in part by Goldman Sachs which also happens to run the world's most widely used commodity price index, the GSCI, which is over-weighted to oil prices.

As I noted in my earlier article, ('Perhaps 60% of today's oil price is pure speculation'), ICE was focus of a recent congressional investigation. It was named both in the Senate's Permanent Subcommittee on Investigations' June 27, 2006, Staff Report and in the House Committee on Energy & Commerce's hearing in December 2007 which looked into unregulated trading in energy futures. Both studies concluded that energy prices' climb to $128 and perhaps beyond is driven by billions of dollars' worth of oil and natural gas futures contracts being placed on the ICE. Through a convenient regulation exception granted by the Bush Administration in January 2006, the ICE Futures trading of US energy futures is not regulated by the Commodities Futures Trading Commission, even though the ICE Futures US oil contracts are traded in ICE affiliates in the USA. And at Enron's request, the CFTC exempted the Over-the-Counter oil futures trades in 2000.

So it is no surprise to see in a May 6 report from Reuters that Goldman Sachs announces oil could in fact be on the verge of another "super spike," possibly taking oil as high as $200 a barrel within the next six to 24 months. That headline, "$200 a barrel!" became the major news story on oil for the next two days. How many gullible lemmings followed behind with their money bets?

Arjun Murti, Goldman Sachs' energy strategist, blamed what he called "blistering" (sic) demand from China and the Middle East, combined with his assertion that the Middle East is nearing its maximum ability to produce more oil. Peak Oil mythology again helps Wall Street. The degree of unfounded hype reminds of the kind of self-serving Wall Street hype in 1999-2000 around dot.com stocks or Enron.

In 2001 just before the dot.com crash in the NASDAQ, some Wall Street firms were pushing sale to the gullible public of stocks that their companies were quietly dumping. Or they were pushing dubious stocks for companies where their affiliated banks had a financial interest. In short as later came out in Congressional investigations, companies with a vested interest in a certain financial outcome used the media to line their pockets and that of their companies, leaving the public investor holding the bag. It would be interesting for Congress to subpoena the records of the futures positions of Goldman Sachs and a handful of other major energy futures players to see if they are invested to gain from a further rise in oil to $200 or not.

Margin rules feed the frenzy

Another added turbo-charger to present speculation in oil prices is the margin rule governing what percent of cash a buyer of a futures contract in oil has to put up to bet on a rising oil price (or falling for that matter). The current NYMEX regulation allows a speculator to put up only 6% of the total value of his oil futures contract. That means a risk-taking hedge fund or bank can buy oil futures with a leverage of 16 to 1.

We are hit with an endless series of plausible arguments for the high price of oil: A "terrorism risk premium;" "blistering" rise in demand of China and India; unrest in the Nigerian oil region; oil pipelines' blown up in Iraq; possible war with Iran…And above all the hype about Peak Oil. Oil speculator T. Boone Pickens has reportedly raked in a huge profit on oil futures and argues, conveniently that the world is on the cusp of Peak Oil. So does the Houston investment banker and friend of Dick Cheney, Matt Simmons.

As the June 2006 US Senate report, *The Role of Market Speculation in Rising Oil and Gas Prices*, noted, "There's a few hedge fund managers out there who are masters at knowing how to exploit the peak oil theories and hot buttons of supply and demand, and by making bold predictions of shocking price advancements to come, they only add more fuel to the bullish fire in a sort of self-fulfilling prophecy."

Will a Democratic Congress act to change the carefully crafted opaque oil futures markets in an election year and risk bursting the bubble? On May 12 House Energy & Commerce Committee stated it will look at this issue into June. The world will be watching.

Global Research Associate F. William Engdahl is author of *A Century of War: Anglo-American Oil Politics and the New World Order* (PlutoPress), and *Seeds of Destruction: The Hidden Agenda of Genetic Manipulation*. (Global Research, available at www.globalresearch.ca). He may be reached at info@engdahl.oilgeopolitics.net.

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F. William Engdahl is a leading analyst of the New World Order, author of the best-selling book on oil and geopolitics, A Century of War: Anglo-American Politics and the New World Order,' *His writings have been translated into more than a dozen languages.*

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