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Oil

An unwelcome rise

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The risk from higher oil prices

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SO THE price of oil is creeping back up towards a record high. A barrel of the black stuff cost around \$75 in London on Tuesday July 10th—or a few dollars less in America—as prices return to the heady days of a year ago. Some analysts, for example at Morgan Stanley, expect them to remain this high, perhaps nudging \$80, for the rest of the year. In nominal terms that would be a record but a record in real terms remains some way off.

To some degree the high price is surprising. Although America's summer driving (and air-conditioning) season is underway, supplies of oil in the world's largest economy are abundant. On July 5th the Energy Information Administration reported that both petrol inventories and crude oil reserves have risen sharply recently, apparently as imports have risen in excess of demand. Getting petrol to the pumps is another matter: America's refinery capacity has been inadequate for years, as oil companies eke out extra production from existing plants rather than build new ones; shipping petrol within America is also hindered by a patchwork of differing air-quality regulations.

America alone accounts for roughly a quarter of the world's oil consumption, but broader concerns also explain the global price. Worldwide demand for oil remains robust, as it does for many other commodities, as Asian economies, especially China, and to a lesser degree European ones continue to grow fast. A stampede of investors keen to cash in on the commodities boom seems to be amplifying the rise in prices.

But supply is a greater concern. Iraq's oil output remains dismally low, even compared with its pre-war level. A political stand-off between the West and Iran (over Iran's suspected nuclear-weapons programme) raises the possibility that its large exports may one day be interrupted by sanctions or by conflict. Islamist terrorist threats, for example in Saudi Arabia, add another layer of uncertainty. The activities of crooks and militants in Nigeria, where attacks and kidnappings by gunmen have closed about a fifth of the country's production, are hurting global supply too. And in general OPEC, the cartel of oil producing nations, is keen to keep prices high to preserve the non-dollar value of their exports. Add to that uneasiness about the supply of other forms of energy, notably gas from Russia to western Europe, and it is clear that energy prices are likely to remain high for some time yet.

How long will that be? Last year the oil price drifted down in the northern hemisphere winter, before rising again in the spring. Of course nobody knows, but the International Energy Agency (IEA) has given warning that supplies are likely to be tight for several more years. Given the faster-than-expected decline of output from mature oil-and-gas fields in politically stable areas (for example the North Sea and Mexico) and the slow development of new energy projects (for example in Russia's east) the IEA expects a growing global dependence on oil from OPEC countries. The cartel inevitably has an interest in keeping prices high enough to produce higher revenues, although not so high as to encourage conservation efforts in consuming countries.

Making any predictions about oil prices in five years' time may be considered folly—doing so means guessing not only the state of various economies half-a-decade from now, but also the likely outcome of existing or pending conflicts in the Middle East and elsewhere—but the danger of prolonged high prices is evident. Speaking to the *Financial Times*, Lawrence Eagles of the IEA's oil market business suggests that given inadequate supply "the only way to balance the market will be through higher prices and a drop in demand", which in turn suggests that high prices risk hampering economic growth.