



Oil is Where the Action Is

Uranium is boring. Oil is where the action is. Last year, uranium prices went through the roof, but this was invisible to the general public, whereas oil price increases have become a central issue in the Presidential election, with Congressional hearings and inquiries. Also, you're never going to see a sitcom about someone who discovers uranium on their property, but oil, that's another matter. (However, there was an episode of "I Love Lucy" where Lucy and Ricky go exploring for uranium in the Western U.S., but that was during the first uranium boom of the 1950s.)

We have previously written that there is not a close correspondence between uranium and oil prices, and recent behavior bears that out. Over the same period in which the uranium price declined by over half (in fact, over \$75), the oil price has doubled, thus the prices of the two commodities have moved exactly in the opposite direction. However, this doesn't mean there aren't some common themes between these two markets, as will be explored here.

Recently, the oil price has retreated after hitting \$133 a barrel, making one wonder whether there is something about the mid-\$130s that represents a resistance point for any energy commodity, including uranium and oil. Of course, once the uranium price hit its zenith, it went into a freefall, not increasing again before it dropped more than \$60, while the oil price has exhibited a tendency to bounce back after it retreats.

In fact, there have been two notable "mini-pullbacks" in the oil price recently. One was related to concerns about oil demand, i.e., that the demand for oil would weaken with successively higher prices. Such a pullback should not be surprising given \$4 gas in the U.S., and much higher prices in Europe. Demand elasticity is much more of an issue in oil than uranium, as there is very little, if any, change in uranium demand at higher prices. Also, there is an income effect in the case of oil, where the more money that is spent on oil, the less that is available to buy other things, which results in a slowdown of overall economic growth, which in turn reduces the demand for oil. Higher uranium prices have essentially no such income effect.

The other pullback, a \$5 drop that occurred last week, was attributed to the fact that the Commodity Futures Trading Commission (CFTC) has started a nationwide probe into higher oil prices, no doubt pressured to do so by U.S. legislators following recent hearings in Congress. Here, the focus is on those nasty speculators, who are alleged to be manipulating prices.

One thing that oil and uranium have had in common is expectation of much higher prices, which can be considered both as a cause and effect of speculation, with the target numbers on a per unit basis expected to hit \$200 or even \$300. We heard this last year in uranium and are hearing it this year for oil. In uranium, speculators were viewed as the problem, and they indeed contributed to the dramatic increase in prices. This is also the case in oil, as speculators are vilified along with the large oil companies.

But perhaps the really key driver for oil is the tightness of oil supplies, reflecting a fundamental supply/demand issue that is ultimately driving price (and driving speculation as well), as discussed recently in The Wall Street Journal. In this regard, the International Energy Agency (IEA) is in the process of a comprehensive examination of the world's largest oil fields, and the preliminary finding is that world oil output could be far less than previously projected. Before, the expectation was that oil and related product output would generally match demand and rise to 116 million barrels per day by 2030. Now, there is concern that production will not even be able to top 100 million barrels a day by 2030.

The reasons given for this more moderate increase in oil supply are aging oil fields and a reduction in investment. As oil fields are depleted, greater investment is required to keep production constant, let alone increase it. There is the belief on the part of the IEA's chief economist that the magnitude of needed investment is much greater than perceived. In an interview with the WSJ, he describes this situation as "dangerous."

There are parallels here with uranium as expanding supply in a timely manner is a major issue in uranium as well. The uranium market has experienced a long period of under-investment in both exploration and production, which contributed to the dramatic run-up in price that occurred. Speculators certainly exacerbated this run-up, but their actions were motivated largely by what they saw as an imbalance between supply and demand. One thing is likely: the story is far from over for both oil and uranium.

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