# Shippers Should Avoid Over Optimism While Seeing Plummeting Oil Prices

## Falling Prices May in Fact Sew Seeds for Even Higher Prices Later; Back to July Levels in Less than Two Years?

**SCDigest Editorial Staff**

What a difference just a few months make.

From record high diesel prices in July, topping out at almost $5.00 per gallon in the US, prices have plummeted along with falling oil prices, to levels now not much above $3.00 per gallon (though in percentage terms diesel prices have not fallen quite as much as regular gas prices yet). (See illustration below.)

The dramatic drop is something of a windfall for shippers, as direct costs for companies that operate their own fleets and rapidly shrinking fuel surcharges from carriers for now at least are producing relief for long stressed logistics budgets.

Nonetheless, shippers shouldn't get too complacent. While prices could fall further, many think we are near a bottom. At these levels, diesel prices are about where they were in late 2007, when there was much concern with rising fuel costs.

The precipitous drop in oil prices also may be sewing the seeds of its own reversal, as development projects that looked to be good investments would now produce negative returns. Meanwhile, while global economic growth and demand for oil has definitely slowed, China's economic growth is still robust, with recent estimates, while reduced, for approximately 9% year-over-year expansion.

Continued increases in overall global demand combined with shuttered development projects could lead to skyrocketing oil price increases in the short to medium term.

Speaking this week at an oil-industry conference in London, Mohamed Bin Dhaen Al Hamli, the United Arab Emirates' energy minister, said that "Low oil prices are very dangerous for the world economy. We need an adequate and reasonable oil price that will continue to stimulate investment." He added that with prices now in the toilet, "a lot of projects that are in the pipeline are going to be reassessed."

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While a representative from an oil producing country naturally might be thought to have a self-serving view on the topic, that sentiment is also being echoed by independent observers. For example, Nobuo Tanaka, head of the International Energy Agency, said at the same conference that "We're concerned that supply won't catch up with demand after this crisis. The supply crunch may come again, but in a more acute way."

For example, oil prices began their long run about five years ago when supply capabilities had not been adequately developed to keep pacing with suddenly surging demand from India and China. Until recently, the buffer between global demand and supply capacity has been extremely tight and at historic lows. While that has eased slightly with falling global demand, the overall demand trend

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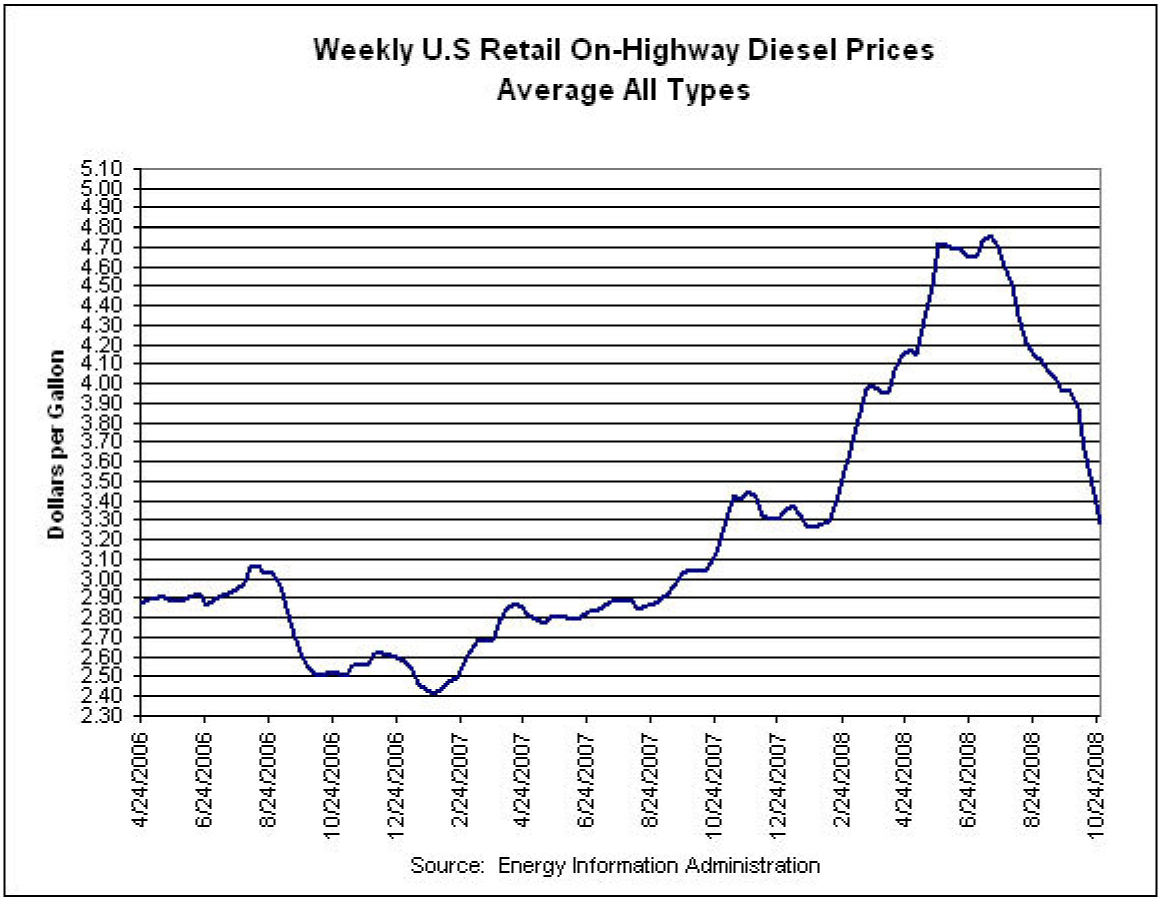


will clearly be up, while exploration and development may be curtailed for now due to falling prices. There could be a long lag time between rising prices and getting those projects back online, further exacerbating upward price pressures.

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The good news is that for now, it appears many major oil companies are not planning to cut back on investments. The Wall Street Journal for example, reports that recent development budgets for Royal Dutch Shell and Chevron are still on track.

Where investments seem particularly vulnerable of course are in high cost or more speculative projects, such as tar sands or deep water exploration that require a higher price of oil to make economic sense. But it was precisely these types of projects that were though to give the globe a better oil cushion in the face of dwindling opportunities from traditional sources.