Analysis: Oil Prices $80 and Higher Befitting Current Market

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Barclays Capital oil analysts believe that $80 or above oil prices are befitting as reverberations following the BP oil spill in the U.S. Gulf of Mexico continue to be felt, Barclays said it a report released earlier this month.

According to Barclays, the fundamentals of restricted supply and economic recovery, which supports higher demand, are in place to support higher oil prices than levels currently seen. Barclays noted that the U.S. Energy Information Administration (EIA) had revised higher its estimate for production lost from the Gulf of Mexico oil spill, noting that U.S. oil production in 2011 could be reduced by 82,000 b/d. EIA also revised its global demand estimates upward for 2010 and 2011, while data from the U.S. Department of Energy continue to showcase robust demand indications for the U.S.

Meanwhile, European Union Energy (EU) Commissioner Gunther Oettinger has said that EU states should also freeze new deepwater drilling as a preventative measure until the causes of the Transocean Deepwater Horizon blowout in the Gulf of Mexico are known and acted upon. Additionally, Norway and China have halted deepwater drilling until the causes of the Macondo explosion are determined, "and the latest EU statement is very much in line with that sentiment being exhibited in the oil industry as a whole."

Barclays reported last month that it sees oil as undervalued at current levels just below $100 due to the impacts of the Deepwater Horizon incident in the U.S. Gulf on deepwater drilling, politicization of the Macondo spill and long-term issues with reputation faced by the oil industry.

Baclays noted that the consequences of the Gulf spill would be more severe than the postponement of Gulf Coast volumes. "Oil will be slower onstream, more expensive to produce, it will be more politicized and there will be less of it," Barclays noted.

In their latest report, the International Energy Agency said it expected world oil demand in 2011 to grow by 1.3 million b/d, or 1.6%. That increase rate is below the 2.1% rise in global crude consumption expected this year, although it is in line with 1.7% growth seen on average annually from 2000 to 2007.

Despite a higher rate of global economic growth projected next year, the IEA said the dual impact of improving energy efficiency in industrialized nations and a gradual phasing out of economic stimulus in emerging markets like China--the fastest-growing oil consumer globally--would slow the pace of oil consumption.

The IEA expects total Chinese oil demand to rise by just 4.8% next year to 9.56 million barrels a day compared with robust growth of 9.1% this year. China is the world's second biggest oil consumer at a distant second to the U.S., which is forecast to burn 18.86 million b/d on average in 2011, down slightly from this year.

The IEA is "usually very conservative about spare capacity as they represent the interests of the consuming nations. They want to keep producers producing and to keep prices low. For them to be talking this way is really astounding and really bearish," said Phil Flynn of Chicago-based PFG Best.

The IEA's latest forecast highlights the more benign view of the global oil market compared with a year ago when many industry observers were warning that a sharp drop in oil exploration spending would hurt future supply and drive crude prices sharply higher by 2010-11. Capital expenditures did drop by almost 20% last year, but are expected to rebound by about 10% in 2010.

However, some potential problems lay ahead, Flynn said. Non-OPEC oil supply is forecast to grow by just 400,000 b/d in 2011, half the growth rate expected this year and far below recent historical averages, due to aging oil fields.

The IEA also cautioned that regulatory and legal uncertainties in U.S. offshore oil drilling, stemming from the Gulf of Mexico oil spill, could cut U.S. oil output by up to 300,000 b/d by 2015.

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