REASONS FOR OIL PRICE DECLINE
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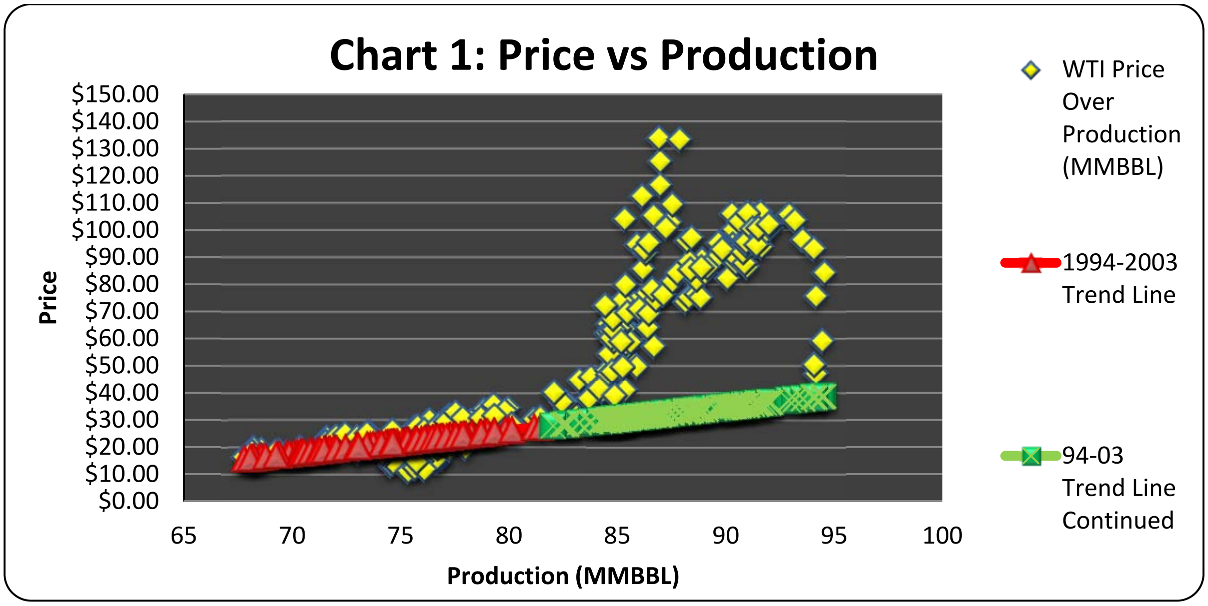
In the volatile realm of oil prices, the world has seen the price of West Texas Intermediate oil (WTI) fall, since peaking in August 2013 at an average price of $106.57 for the month and staying elevated until July 2014 where the price averaged $103.59, to an average price low of $47.22 for the month in January 2015. Oil prices are a commodity, a primary good, with prices controlled by the markets; thus, not one factor, but many, determine the price at which oil is sold in the commodity markets.

Part of the reason for the declining oil prices is that the global supply has increased, especially with the recent boom in production within the United States and global demand has not increased to the extent predicted. Some of the slower demand growth in the global market is due to increased efficiency, especially in the automobile markets where the average motor vehicle gasoline consumption has become more efficient, ahead of the new vehicle efficiency standards, which will require automobile companies to have their fleet average 54.5 MPG by 2025.[1]

One of the theories about the falling oil prices is that they are reverting closer to the trend line established in the 1994-2003 period. Taking the trend line from this period, based on production and price, the escalation that followed from 2004 to the summer of 2014 signifies a bubble for oil, which is now being corrected (Chart 1). That isn't to say it will stay near the trend line for long; the oil market is determined by the market price, which does not always follow the fundamentals of how a market should react towards events.

Table 1. Price vs Production



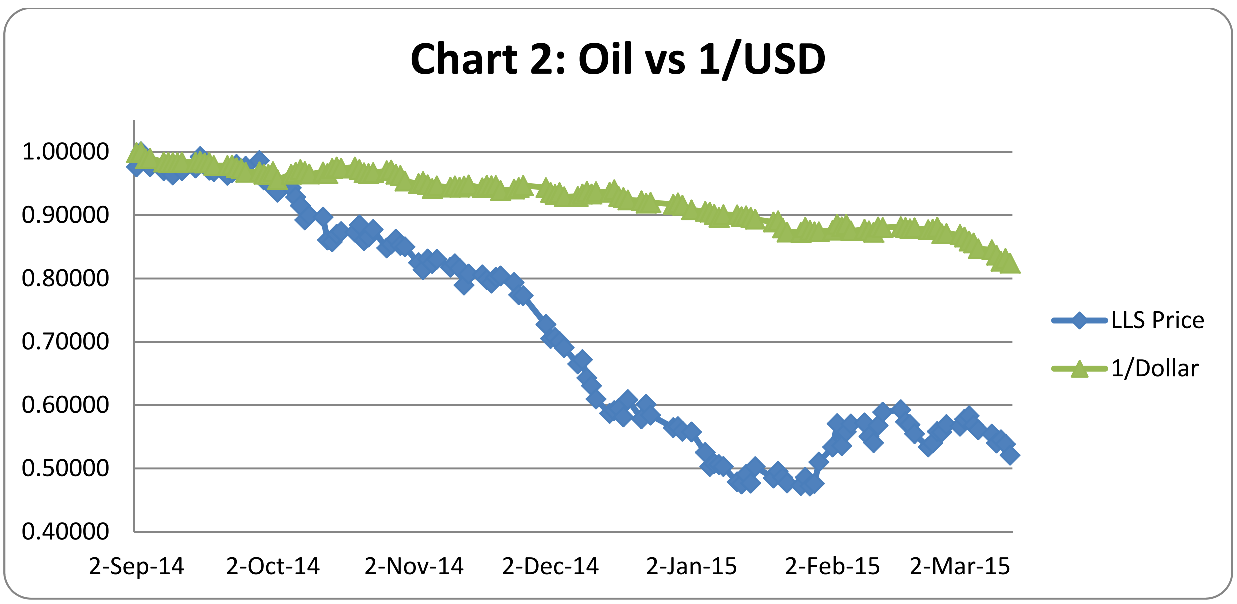
Source: Louisiana Department of Natural Resources/ Technology Assessment Division

[1] Autos must average 54.5 MPG by 2025, new EPA standards say. Juliet Eilperin, August 28, 2012. http://www.washingtonpost.com/national/health-science/autos-must-average-545-mpg-by-2025-new-epa-standards-are-expected-to-say/2012/08/28/2c47924a-f117-11e1-892d-bc92fee603a7_story.html

The total US commercial crude inventory peaked on April 24, with a supply of 491 million barrels.[2] In recent weeks, those supplies have fallen back a bit, with 479 million barrels in inventory for the weekend ending May 22.[3] Prior to the development of tight oil, weekly averages hovered in the 320-million barrel range. Since 2009, the supply has steadily been increasing, peaking in April. The slight retreat in commercial inventories in recent weeks has also signaled an increase of oil prices. The close of WTI was $43.39 on March17; on May 12, the close was $60.72, an increase of 39.94%.

Another theory about the falling price of oil is that the dollar is responsible for the decline in oil rather than the supply. Chart 2 has the inverse value of the dollar (the inverse value would reflect the opposite of what is happening in the market, in this case a decline rather than an increase, which is easier to show the correlation) and the value of oil for the period September 2 through March 15, with September 2 used as par. While the increasing value of the dollar cannot completely account for the decline in oil prices, the decline cannot be overlooked as a catalyst, which helped stimulate the precipice. As seen in the data, during the period for the month of September there was high correlation between the increasing dollar and the decline in oil prices. During that time, Louisiana Light Sweet (LLS) prices declined by 4.90%, and the value of the dollar increased by 3.08%.

Table 2. Oil vs 1/USD



Source: Louisiana Department of Natural Resources/ Technology Assessment Division

While there has been no single factor leading to the decline of oil prices in the past year, there has been a confluence of circumstances that lead to the price decrease we have experienced over the past year. The strength of the dollar, increasing inventories, and an oil bubble influenced the decreasing prices within the commodities market. One thing to watch in the future is the amount of consumption emerging markets, such as China and India, demand. An increase of demand in those markets will allow global consumption to expand, and the market prices will reflect that demand.

[2] http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=WCESTUS1&f=W

[3] Ibid.