QUARTERLY Energy Update
Federal Reserve Bank of Dallas

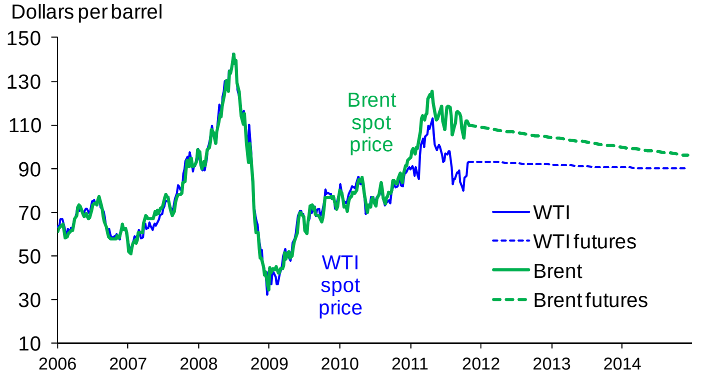
Oil Prices Fall as Global Growth Slows

November 7, 2011

Oil prices declined in the third quarter, with West Texas Intermediate (WTI) prices falling 17 percent, from $95 on June 30 to $79 on Sept. 30. Brent crude prices also declined but by 6 percent, from $111 to $105. Since the beginning of October, oil prices have rallied, with WTI recently trading above $93 per barrel and Brent topping $112 (*Chart 1*).

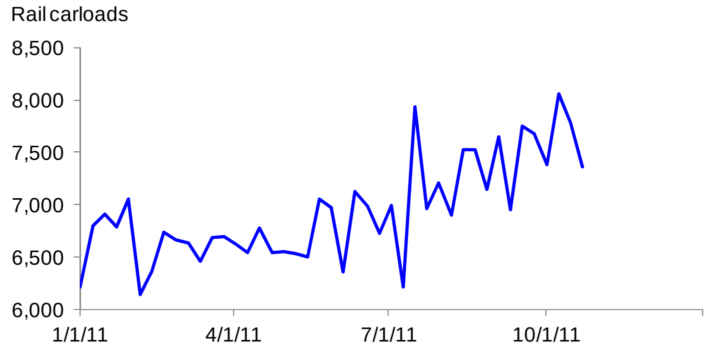
WTI prices were pressured by abnormally high inventories at Cushing, Okla., and in the Midwest more generally. Increasing amounts of oil are flowing in from the Bakken region in North Dakota and from Canada, yet there is no efficient means of piping it out to the Gulf of Mexico and other end markets. This has led to downward price pressure relative to global oil benchmarks. Currently, rail tanks are being used to divert some of the excess oil (*Chart 2*). Longer-term pipeline capacity is expected to be added and should narrow the gap between Brent and WTI prices within a few years (*Chart 1*).

Chart 1
Oil Prices Decline



SOURCES: Bloomberg; *Wall Street Journal*; Energy Information Administration.

Chart 2
More Oil Being Moved by Rail Due to Bakken Production



SOURCE: Atlantic Systems.

Modest Relief at the Pump

Gasoline prices also declined in the third quarter. But because gasoline prices track international oil prices more closely than WTI prices, this has resulted in less relief at the pump for consumers than might be expected (*Chart 3*). From the end of June through the end of September, retail gasoline prices fell 7 percent to $3.57 per gallon but are still up almost 21 percent from $2.90 a year earlier.

Global Supply Increases Slightly

According to the International Energy Agency (IEA), overall global supply grew by 1.2 million barrels per day (mb/d) in the third quarter to 88.7 mb/d, up from 87.5 in the second quarter. Increased OPEC production made up 0.8 mb/d of this.

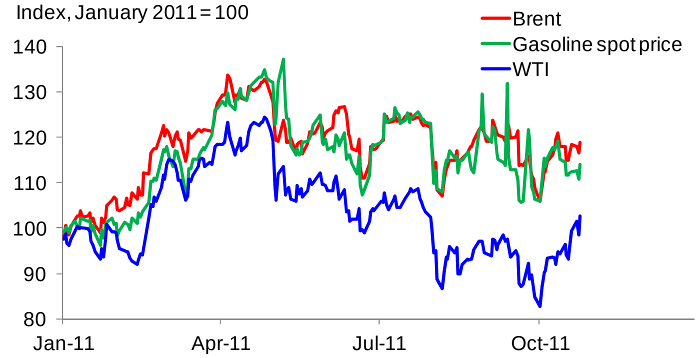
The Libyan civil war came to an end at the close of the third quarter. Recent reports suggest that the country is now producing about 400,000 barrels per day (b/d) of crude oil. This is approximately 25 percent of its prewar production. However, some of the current production appears to be going to domestic demand and storage rather than world markets.

The third quarter also saw its share of non-OPEC supply disruptions (*Chart 4*). The latest estimate, at 650,000 b/d, significantly exceeds any additional production seen from Libya. These disruptions are expected to continue into the fourth quarter, with outages projected to be 460,000 b/d. Non-OPEC supply was expected to increase in the third and fourth quarters as new projects came online. However, the IEA recently revised its estimates of this new production downward because the projects ramped up more slowly than expected.

Growth in Petroleum Demand Moderates

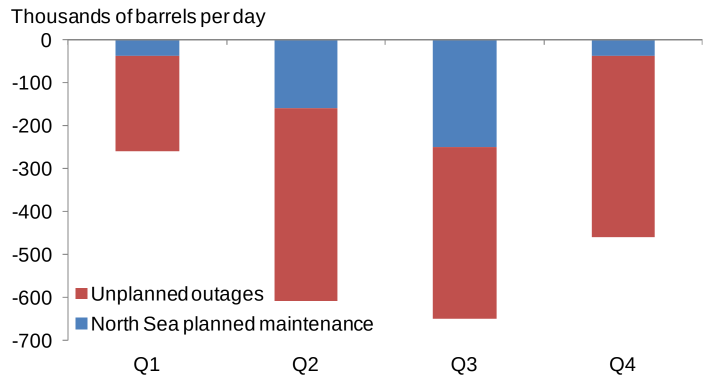
Global petroleum demand growth has moderated overall but is mixed across regions. In the developing world, demand growth has slowed compared with the rapid rate of increase seen in 2010 and early 2011.

Chart 3
Gasoline Tracks International Oil Prices



SOURCES: *Financial Times*; *Wall Street Journal*.

Chart 4
Adjustments to Non-OPEC Supply in 2011



SOURCE: International Energy Agency.

China, in particular, has seen demand growth slow. This is likely due to general macroeconomic conditions, as well as government-regulated prices of gasoline and diesel holding steady after increasing in April. In addition, automobile sales in China rose drastically in 2009 and 2010 due to government incentives but have slowed in 2011.

Oil demand in the U.S. and Europe has been weak, and a reversal of this trend seems unlikely to occur soon. The latest IEA forecast has year-over-year demand growth for 2011 shrinking in both North America and Europe (Chart 5), with the U.S. driving the numbers for North America. Demand in Asia is expected to be higher than originally predicted, in part because of Japan's move toward the use of oil for electricity generation.

Natural Gas Prices Decline

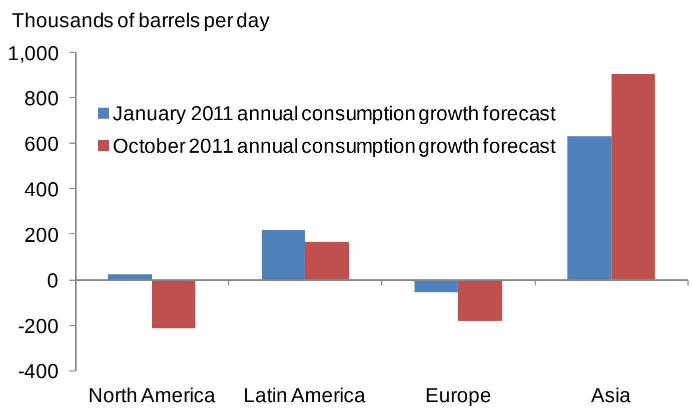
Natural gas prices fell in the third quarter. Supply continued to grow, thanks to shale gas production, and demand fell with the easing of record-breaking summer heat (Chart 6). After averaging slightly above $4 per million British thermal units for much of the third quarter, prices are now hovering around $3.60. With winter approaching, prices should see a seasonal increase as the end of the year nears.

—Jackson Thies and Michael Plante

About the Authors

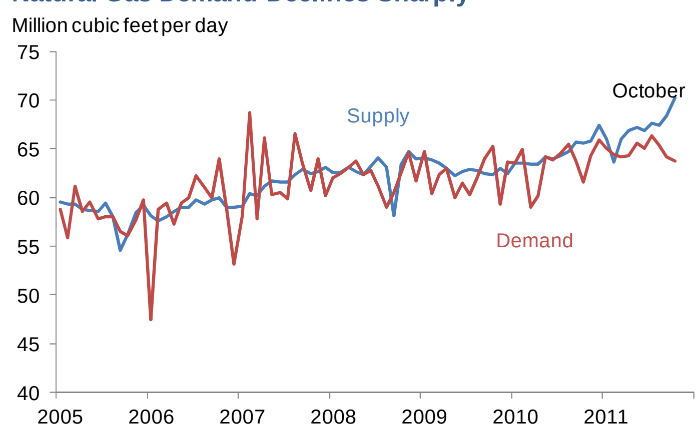
Thies is a senior research analyst and Plante is a research economist in the Research Department at the Federal Reserve Bank of Dallas.

Chart 5
IEA Predicts Oil Demand to Shrink in U.S. and Europe in 2011



SOURCE: International Energy Agency.

Chart 6
Natural Gas Demand Declines Sharply



SOURCE: Bentek.