TRENDS AND OBSERVATIONS

Supply, demand and expectation

BY RAUNO PERTTU

Like many of us, I've been following the debates on whether or not to allow offshore drilling for oil, or whether to develop alternative energy sources when, critics say, this will only make a ten or fifteen percent difference in energy or oil supply. Often, the argument that the energy source in question will only last a few years is added to the dismissals. In these discussions, ten percent differences and ten-year time periods tend to be brushed off as insignificant. This perception is fundamentally wrong. Small differences in supply and demand and in the attitudes of purchasers can create huge differences in price and availability.

Years ago, when I was Director of Business Development for Kennecott, which was then the world's largest copper company, I learned that small shifts in supply and demand created much larger shifts in pricing and in corporate economic health. At that time in the mid-1980s, copper languished at $0.60 per pound. Ten years earlier, in 1974, copper prices had peaked at $1.74, and in 1980 were still around $1.50 per pound. The difference between $0.60 copper and $1.50 copper was the difference between billions made and billions lost. In other words, the difference was corporate life and death. Interestingly, these differences in price, ranging from 150 to 300 percent, were created by differences in supply and demand of much less than 10 percent. Very modest changes in available supply versus customer demand resulted in huge changes in price.

Copper prices have had a steady climb over the past five years from below $1.00 per pound to more than $4.00 earlier this summer. A very recent price drop to about $3.40 was triggered by expectations of slowing demand.

In an even more remarkable climb, the price of molybdenum, a steel-hardening alloy, climbed from a depressed price of about $3.00 per pound in 2002 to more than $40.00 in 2005. This price explosion was triggered by purchaser expectations of supply shortfalls resulting from increased Asian demand. The molybdenum price remains above $30.00 per pound.

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In these cases, small supply and demand swings created multiplied price increases. That small swings in supply and demand create multiplier effects is true in many commodities.

It's hard to remember that oil prices hovered significantly below $20 per barrel in 1999. Those prices peaked above $140 nine years later, this July. While oil demand increased less than 20 percent in those nine years, the per-barrel price increased ten-fold.

Factors other than straight supply and demand obviously contribute to major price swings for commodities. One important factor is expectation and buyer worries about supplies. Buyers and sellers can trigger exaggerated price swings because they are paid to anticipate supply shortages and surpluses and to act before the expectation becomes reality.

Buyers for molybdenum became worried that they wouldn't have the supplies they needed for their steel production, especially because they saw a growing market demand from China and India. Buyers reacted in a bidding war for supply contracts to control supplies ahead of their actual needs. Their competition squeezed the available supply contracts and created an instant surge of panic buying which lead to the beginning of the abrupt rocketing of molybdenum prices.

At the other end of a boom cycle, when buyers worry about being left with surplus inventory, a sort of mirror image effect takes place. Buyers can worry about having spent too much money to corner too much supply that may not be needed in the near term. They suddenly can stop buying in anticipation of reduced consumption, and thereby create a downward price spiral. Resource producers usually have major investments and overhead in production capacity, and can't just stop producing with a slowdown in buying, so they start competing for a shrinking number of purchase contracts and prices drop.

Oil prices have similarly been impacted by the traditional supply, demand and expectation concerns described above. Growing demand by China and India have been major factors in the rocketing of oil prices. Additionally, contrary to what most people believe, oil prices today are more influenced by the actions of OPEC and by other factors than by sneakiness of the large oil companies. This is not to say, however, that large oil companies aren't doing their share to move oil prices upward.

Oil prices also have been pushed upward by other factors. One is the concern that much of the world's oil supply is from unstable and often unfriendly countries that could squeeze the world's needs at any time. Another is the price of our dollar. Most of the world's oil is still traded in U.S. dollars, and with the dollar in a continuing slide, oil sellers, who are international, have been raising oil prices to maintain profits. Remember, many of their currencies have risen relative to the dollar, so they have had to raise oil prices even more to maintain their profits.

As for the argument that increased oil supplies aren't worthwhile if they only represent a few years of additional consumption, the reality is that changes can't happen overnight. Obviously, we need to change our energy sources and efficiency because we can't keep burning increasing amounts of fossil fuels indefinitely. Our fossil fuels are finite and the burning of fossil fuels contributes to increasing carbon dioxide. Part of any sane energy policy has to be the development of a suite of alternate energy sources and applications. However, these necessary changes will take time and will come with a large price tag. Assuming the needed changes to alternative energy uses are initiated without a crisis (which may be wishful thinking), we will have a much stronger economy to fund the transition if we have a continued oil supply. Adding new reserves for a few years will buy us time to make the necessary changes in energy policy without further disrupting our economy.

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Applegater to be online in September!

Beginning in September, the Applegate Valley Community Newspaper will publish on the Internet a website that is a companion and expansion of the content and services that the printed ***Applegater*** newspaper provides.

Highlights of what this website will offer include:

- I**ndex and viewable/downloadable issues** of the *Applegater* starting from March 2008.
- **Expansion of content and pictures** of selected articles that appear in the printed paper.
- **Community calendar** that everyone can post to by contacting our webmaster via email.
- C**ommunity services directory** with contacts, current activities and bulletins for all our major community services such as police, fire, library, BLM, etc.
- **Directory of local businesses.**
- **Listing of websites** that pertain to the Applegate Valley.
- **Changing collection of images** of scenery and activities within our beautiful valley.

Starting in early September we encourage you to log on to http://applegater.org

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