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BP Spill Shows a Profit Buying 2018 Oil, Selling Spot (Update3)

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(Bloomberg) – The oil market is signaling that prices have nowhere to go but up as the biggest spill in U.S. history curbs drilling and makes it more expensive to develop new fields.

Crude's premium for delivery in eight years rose 86 percent since the April 20 explosion at the BP Plc-leased Deepwater Horizon rig in the Gulf of Mexico, based on June 4 prices. Oil for December 2018 was \$22 a barrel more than for next month, compared with \$11 before the disaster. More regulation may add \$5 to the long-term contracts, according to Deutsche Bank AG.

President Barack Obama extended a ban on new deepwater permits and exploration by Royal Dutch Shell Plc in the Alaskan Arctic for six months, putting off-limits as much as 23.2 billion barrels of potential resources, equal to 76 percent of all reserves

proven in the U.S. The number of rigs drilling in the Gulf of Mexico plunged 50 percent last week to the lowest level in 16 years, Baker Hughes Inc. reported June 4.

"The president said stop drilling, and now we are seeing the result," said Adam Sieminski, chief energy economist at Deutsche Bank in Washington. "Before all is said and done, we're going to lose more rigs in the Gulf."

A one-year worldwide delay in deepwater drilling may cut 500,000 barrels a day from 2013 supply, according to Sanford C. Bernstein analysts. While that's less than 3 percent of daily U.S. consumption, it's almost enough to fuel Argentina, Latin America's third-biggest economy.

Future Oil

Oil for delivery in December 2018 traded at \$92.78 a barrel on the New York Mercantile Exchange on June 4, compared with \$71.51 for July 2010 delivery, a premium of \$21.27. That spread grew by \$9.82, or 86 percent, between June 4 and April 19, the day before the accident.

The spread widened to \$22.73 a barrel today as the December 2018 contract jumped \$1.39, or 1.5 percent, to settle at \$94.17 a barrel on the Nymex. July crude dropped 7 cents to \$71.44.

To profit from a wider premium, investors would need to buy a December 2018 futures contract and sell one for nearer delivery, and then reverse those trades once the spread expands.

As prices approach \$100 for delivery in 2018, the latest contract on the Nymex, crude for this year is sinking on concern Europe's debt crisis will derail the global economic recovery. July oil fell 14 percent in May, the most for one month since December 2008. Prices tumbled 4.2 percent on June 4 after a government report showed that the U.S. added fewer jobs than forecast last month and as the euro fell to a four-year low against the dollar, reducing the appeal of commodities.

Share Slump

BP shares have collapsed, losing 33 percent of their value since April 19 amid mounting costs of the clean-up and damage to the company's reputation. The slump has been felt across the industry, leading to a 14 percent decline so far this year in the MSCI World Energy index.

The prospect of higher costs and a crackdown on drilling are driving up future prices because world demand in 2015 will rise 2.3 percent from now to 88.4 million barrels a day, according to the International Energy Agency in Paris.

"Definitely there's going to be greater regulatory scrutiny over offshore operations in the deepwater, and that would likely lead to increased costs for the industry," David Greely, chief commodities strategist at Goldman Sachs, said today at the Asia Oil & Gas Conference in Kuala Lumpur.

Production Reduction

U.S. output may be cut by 150,000 to 200,000 barrels a day next year because of new limits, Deutsche Bank's Sieminski said. The total can feed as much as 35 percent of Exxon Mobil Corp.'s refinery in Baytown, Texas, the largest in the U.S.

BP estimates its production may be reduced by 75,000 barrels a day in 2015 because of delays.

Those amounts are too little to drive up the cost of crude, said Mike Wittner, head of oil research at Societe Generale SA in London.

"In the big picture, I don't think a half million barrels a day of more or less non-OPEC production is really going to change the global balance," Wittner said in a telephone interview. "It is still going to be Asian-led demand growth bumping up against a maturing supply base." The big picture does not really change." Wittner forecasts oil averaging \$101 a barrel next year.

Brazil has given no signs that limits will be placed on Tupi and related deepwater oil fields, the biggest discovery in the Americas since Mexico's Cantarell in 1976.

OPEC Reliance

The fewer barrels pumped in the U.S., the more refiners need to turn to the 12-nation Organization of Petroleum Exporting Countries and other foreign suppliers. To meet rising demand, OPEC would activate unused fields, curtailing capacity the world needs during times of disruptions, such as wars and hurricanes. A 500,000 barrel-a-day drop in global output in 2013 would put a greater burden on OPEC, Bernstein analyst Neil McMahon said in a May 28 report.

"Although this may seem small in a global context, such a situation would decrease OPEC spare capacity, especially in the second half of the decade, which would lead to an increase in the oil price," according to the report.

The world is growing more dependent on deepwater finds, focusing attention on hard-to-access fields such as Brazil's Tupi and BP's Thunder Horse in the Gulf of Mexico. Reservoirs lying more than 1,000 meters (3,280 feet) below the sea surface will make up almost 4 million barrels of daily global production by 2018, more than six times the level this year, according to Bernstein estimates.

Output Growth

Offshore production growth may be slower than expected, pushing up prices, said Fatih Birol, IEA chief economist.

"There could be definitely a negative impact on the offshore product growth, which may in turn mean upward pressure on prices," Birol said in a telephone interview. Higher oil prices may provide an incentive to look at alternatives to oil.

OPEC accounted for 41 percent of U.S. imports last year, down from 46 percent in 2008, according to the Energy Department, in keeping with the goals of Obama and previous American presidents to curb dependence on foreign nations.

"Much of our future supplies were supposed to come from deepwater drilling," David Hufton, managing director of London's PVM Oil Associates Ltd., the world's largest broker of over-the-counter crude trading, said in a note. "The environmental risks are now all too apparent."

Spill's Cost

The spill has dumped as much as 19,000 barrels a day into the Gulf, according to government scientists, after the initial explosion killed 11 workers and sank a \$365 million rig. BP has spent about \$1.25 billion to stop the flow and scour crude from the Gulf, it said today.

"We owe all those who've been harmed, as well as future generations, a full and vigorous accounting of the events that led to what has now become the worst oil spill in U.S. history," Obama said in the Rose Garden on June 1.

Oil producers around the world are preparing for stricter regulation. Norwegian government members are calling for an immediate stop to deepwater drilling offshore, while Russia may tighten its rules, according to Energy Minister Sergei Shmatko.

"We need to guard against premature changes to regulations that may not turn out to be the right thing," Andrew Swiger, senior vice president at Exxon Mobil Corp. said in Kuala Lumpur.

More regulation means more expenses to consumers through higher commodity prices. Insurers are charging 50 percent more for policies covering oil rigs following the explosion, according to Moody's Investors Service.

"The marginal costs for new supplies have taken a big upturn," said PVM's Hufton. "It is surprising that forward oil prices have not reacted more aggressively."

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