

RISING OIL PRICES AND THE CRIPPLING OF OUR ECONOMY

June 21, 2005

Oil Price Update (As of June 21, 2004)

World Oil Prices have set record highs once again. After taking a breather in the month of May, diesel has surged from \$59/barrel last month to \$74.34/barrel as of June 20, 2005 (surpassing the April 4, 2005 record of \$73.55/barrel). The \$15 rise of diesel in less than a month has never been seen in the past. The average price of diesel for June of \$70.91/barrel is also an all-time high. Unleaded as of today is \$62.83/barrel and continues its climb towards its record high of \$65.58/barrel set last April 4, 2005.

Dubai Crude has also set a record-high of \$52.77/barrel (after going as low as \$44/barrel last May). WTI has also set an all-time high in both spot price and monthly average as of June 20, 2005 at \$59.19/barrel and \$55.37/barrel respectively. Brent Crude is at \$57.43/barrel, also an all-time high.

Prices have surged even after OPEC's decision to raise oil output by 1M barrels/day (500,000 barrels last week and another 500,000 barrels on the OPEC President's call) sending signals that demand remains very strong even at these record prices. Some analysts point at infrastructure insufficiencies in both upstream and downstream (refining capacity) as a continuing concern. Barclays Capital says that prices will have to rise to a level where demand begins to contract. Some experts say \$100-\$120/barrel crude could be that level.

Oil prices have risen by more than 5000% since 1971, by 600% since 1999, and by 47% in the last 6 months alone.

Iran's OPEC governor said, "At the moment, OPEC is not capable of cutting down prices much, despite all its efforts to supply oil at the highest capacity" and added, "The latest increase of output ceiling will not be able to solve any problems of the market".

Mexico's Energy Secretary said that Mexico was currently pumping at full capacity and could not be expected to export greater levels of crude in the foreseeable future. Most of the oil producing countries experience similar peaking productions thus cannot provide the extra supply of oil to address the surging demand resulting to the relentless increase in prices. This situation is expected to get more acute in the years to come.

Global Demand Analysis

Daily world oil demand stands at 87 M barrels. Global proven reserves stand at 1.047 trillion barrels. Everything held constant, supplies are good for 33 more years before running out. But demand will grow and the USDOE says global output must grow by 45.3 M barrels/day by 2025 to satisfy this projected demand. Which means the reserves could be good for less than 25 years unless investments pour in. The investments needed are estimated to be at \$3T and it remains uncertain if they will invest that amount.

The United States consumes 25% of total world supply of oil with only 5% of world population in their territory. Europe and Japan are more dependent than the United States on oil from the volatile Persian Gulf. China is the fastest growing economy and needs all the oil it can get from the Persian Gulf. India is another giant economy that has started to awaken.

300 million Chinese are reported to earn more than \$2000/year. At this level, car-buying has taken off in other developing countries. Soaring demand for fuels in China has begun. An average Chinaman consumes 2 barrels of oil per year. An average American consumes 30 barrels of oil per year. If China's target were to match the sophistication of the American standard of living within a decade's time, they would be need and consume 45 billion barrels/year, enough to wipe out the entire Saudi Arabian reserve in less than 5 years.

It is expected that international competition will intensify over the same unreliable sources of oil. Indications of peaking supplies are more evident now than ever. Thus, with less oil available, competition for it will increase, and the struggle for its control will become more and more acute than ever. World prices are expected to continue surging to new highs, setting record after record, year after year.

The Philippine Situation

As the saying goes, oil makes a country strong, dependence makes it weak. So how dependent are we? This is my analysis:

The Philippines In 1995 --- oil bill/GDP = 7.7%

The Philippines In 2004 --- oil bill/GDP = 22%

At present, the countries import bill stands at P320 billion. Our GDP stands at P1.46T. Our economy suffers because of the continued shift of massive resources to oil producing countries. A big amount of our resources have gone exclusively to the purchase of oil.

To compare:

United States--- energy bill (not just oil)/GDP = 6%

China --- oil bill/GDP = 2.28%

Clearly, the Philippines are in a graver state than the two countries mentioned. Neighboring countries such as Thailand, Malaysia, Indonesia, and Vietnam not only have oil reserves but also have stronger economies thus their ratios are in the single-digits. Our 22% ratio is one of the worst in Asia.

Assuming our exchange rate falls to P70/\$, oil prices rise to \$100/barrel, and demand grows by 20% all in the next 3 years, our total oil bill will be a whopping P981 billion, almost the size of the entire annual national budget of this republic. Assuming once again that our GDP remains flat at 1.46T due to rising prices, 981 b/1.46 T, and our oil

bill to GDP ratio will rise to 67%. At this level, we would absolutely be one of the worst in the world with an economy that is more fragile than any. Just to maintain present ratios, our GDP has to surge to improbable levels of P4.5T by 2008. This is more than double the estimates of NEDA by 2014. At the very least, our economy is on trek to a disaster.

What must be done?

We must continue our quest towards energy independence. The Department of Energy must achieve this through aggressively pursuing the following: a) increasing our indigenous oil and gas reserves, b) aggressively develop our renewable resources such as geothermal, hydropower, biomass, solar, wind and ocean energy sources, c) increase our use of alternative fuels, d) forge strategic alliances with other countries and e) implement a strong energy efficiency and conservation program.

We must amend the Oil Deregulation Law and make it a catalyst for the proper development of our local industry such that we achieve price stability and a reliable supply of fuels at all times. Focus should be on: a) expanding and enhancing refinery capacity and quality in the country, b) promotion of more investments in refinery operations, c) promotion of more investments in oil and gas exploration, and d) promotion of more investments in lower-priced oil purchases abroad outside of Singapore and other traditional sources.

Most countries that deregulated their oil industries ensured they had sufficient refining capacity, sufficient proven reserves underneath their territories, and the necessary fuel stockpile infrastructures in place, all of which would ensure stability of prices and security of supply. The Philippines had none of the above entrusting all development in the hands of the new players of the oil industry.

Seven years after deregulation, things had not gone as anticipated. We have lost Caltex as a refinery with Shell hinting of closure in the near future. There have been no investments on fuel stockpile infrastructure or in additional refining capacity. Most of the investments of the new players have been in gas stations to the point of over-capacity. Even the refiners have resorted to importing fuels and blending with their products in lieu of upgrading their refineries to be Clean Air Act compliant. This importation has contributed to driving the prices higher. The Supreme Court complicated matters by deeming as unconstitutional minimum reserve requirements for the oil industry and tariff differentials to promote refinery investments.

Given the above, the Department of Energy must establish a National Petroleum Strategic Reserve by 2010 through one or a combination of the following: a) Discovery of oil reserves and the provision of all equipment and personnel necessary to take the oil out on declared days of emergency. b) Investment in oil stockpiling infrastructure with capacity of 30-45 days and the provision of funds for purchase of fuels to be filled in the tanks, c) Granting of concessions and subsidizing coal royalties to the Coal-to-Liquid fuels project in exchange for a commitment to provide 60,000 barrels per day (for 30-45 days) of

crude or finished products on declared days of emergency, and d) harness the development of the Malampaya Oil rim, dedicating it to our national reserve.

The Department of Energy must also move forward in promoting the use of natural gas (and reduce the use of diesel) through the following: a) Open access to the Malampaya natural gas reserves would lead to more investments in refilling natural gas stations and purchase of natural gas buses b) Set up of an LNG terminal in Cavite or Bataan so as to begin transformation of Metro Manila's fleet of vehicles to natural gas, c) Set up of LNG-fired power plants as provisional power for the grid due to its versatility and cost-efficiency, d) Convert the Bataan Nuclear Power Plant to a gas-fired plant of same capacity. With the proximity of the LNG terminal, an LNG power plant could be a viable option. This conversion could be at no cost to government dependent on what equipment within the nuclear plant can be traded for value.

Conclusion

High and higher oil prices are here to stay and there is no stopping its climb past the \$100/barrel mark in the next two years or less. The rising oil bill to GDP ratio is an indication that we are paying more and more for imported oil while our economy earns insufficiently to cope with rising prices. It is a concrete parameter that oil has an ever-increasing influence over inflation leading to more severe price fragility of our basic commodities. And lastly, unless halted, it is a clear warning that we are moving ever-closer to certain economic and political disaster.

The rising ratio is a trend that must be stopped at all cost. The economy must be revived and revitalized to its best levels ever and at the soonest possible time if we are to avert a crisis of this magnitude. The oil industry has not developed the way we wanted it to and we have to change its course now. The oil deregulation law has not been a catalyst to growth thus it must be immediately amended and improved. The above-mentioned programs and policies of the DOE are a necessity and there is absolutely no time to delay any of them.

In closing, the expanded VAT is a bitter first pill towards economic recovery. Come July 1, 2005 we shall taste this painful bitterness. Sadly, there is a bigger and bitter pill that we have to deal with, one that has the potential of wiping out all our sacrifices of the past. The problem of rising world oil prices and its crippling effect on our economy is far larger and disastrous than we ever expected. The present political events have not helped at all. The biggest national threat ever is before us now. Nothing less than acting as one nation can we tame the cancer of oil and avert an economic crash come 2008.