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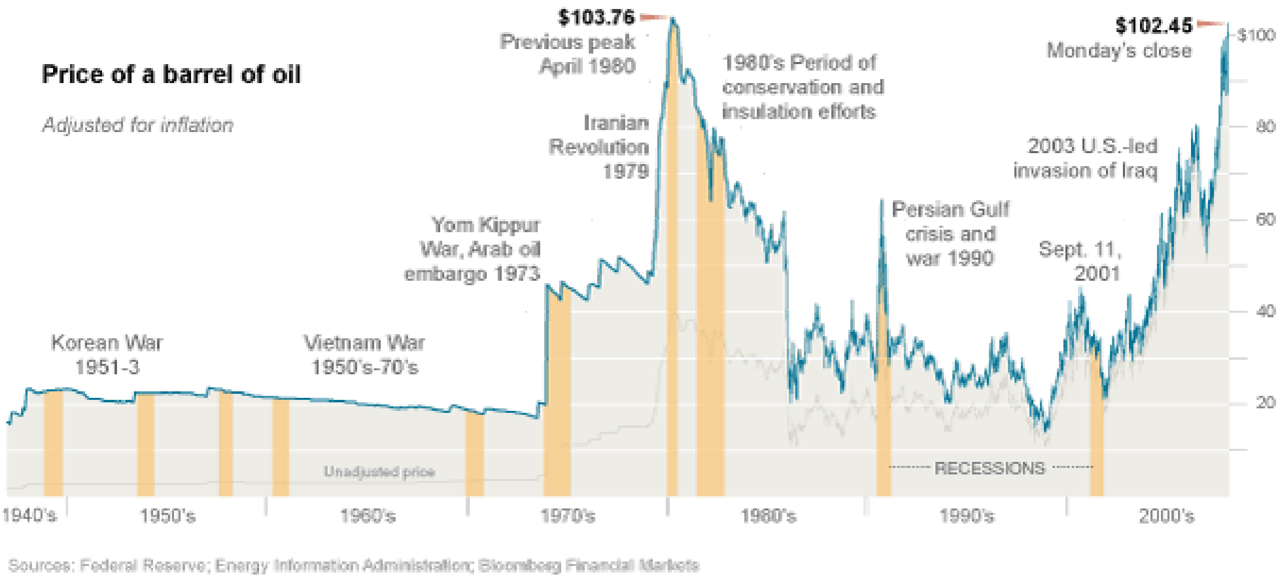
Oil Tops Inflation-Adjusted Record Set in 1980



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By JAD MOUAWAD
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Capping a relentless rise in recent years, oil prices hit a record high during the day on Monday, then pulled back to close below the record.

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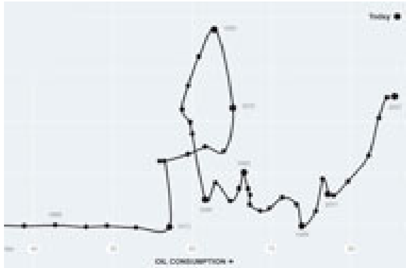
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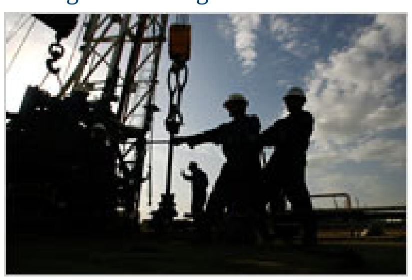

Jorge Silva/Reuters

Oil field work being done in Cabimas, Venezuela, on Saturday. OPEC, which has Venezuela as a member, is expected to leave production levels unchanged.

The day's highest trading price, $103.95 a barrel on the New York Mercantile Exchange, broke the record set in April 1980 during the second oil shock. That price, $39.50 a barrel, equals $103.76 today, when adjusted for inflation.

The surge in energy prices is taking place as investors seek refuge in commodities to offset a slowing economy and a declining dollar. Analysts pointed out that financial institutions like pension funds and hedge funds are also buying oil and other commodities like gold as hedges against a rise in inflation.

That trend is expected to continue, especially after Ben S. Bernanke, the chairman of the Federal Reserve, signaled last week that he was ready to cut interest rates further to bolster economic growth, despite rising consumer prices.

“When investors lose confidence in the central bank, they tend to look for hard assets,” said Philip K. Verleger, an economist and oil expert. “The Fed’s capitulation on inflation is driving investors to commodities.”

For example, Calpers, the California Public Employees’ Retirement System, the largest United States pension fund, said last week that it might increase its commodities investments sixteenfold to $7.2 billion through 2010, to benefit from an across-the-board surge in commodities like gold, silver, oil and wheat.

The latest catalyst for the spike in energy prices has been the recent fall in the value of the dollar, analysts said. Currency traders are selling dollars and buying euros to take advantage of the difference in interest rates between the United States and Europe.

After steep declines last week, the dollar dropped to a record $1.5274 against the euro on Monday before recovering somewhat. It also fell to its lowest level in three years against the Japanese yen.

Like many commodities, oil is priced in dollars on the international market. A falling dollar tends to buoy oil prices in part because consumers using stronger currencies, like the euro or yen, can afford to pay more per barrel.

“The question for oil is, Where is the dollar going?” said Roger Diwan, a managing director at PFC Energy, a consulting firm in Washington. “That’s going to be the main market mover in the short term.”

Since 2000, oil prices have more than quadrupled as strong growth in demand from the United States and Asia outstripped the ability of oil producers to increase their output.

The rising prices of the past decade failed to dent global economic growth as consumers absorbed the higher costs. Even now, with the United States economy slowing markedly, the trend has not slowed much. Global oil consumption is still expected to increase by 1.4 million barrels a day this year, driven by demand in China and the Middle East.

Still, today’s market climate is markedly different from the energy crises of the 1970s and 1980s. These were brought about by sudden interruptions in oil supplies, like the 1973 Arab oil embargo, the Iranian revolution of 1979 or the outbreak of the war between Iran and Iraq in 1980.

Also, the United States’ economy was once much more dependent on oil than it is today. The amount of oil needed to increase economic output by $1 has dropped by 25 percent since 1990.

In the early 1980s, energy accounted for about 8 percent of disposable income in American households. As the economy became less energy-intensive and prices declined, that share fell to under 4 percent in the early 1990s.

But as prices keep rising, the share of energy spending has been increasing. It reached more than 6 percent of household disposable income in December.

Other energy futures also rallied on Monday. Gasoline and heating oil futures both jumped to records. Natural gas prices, which are up 24 percent since the beginning of the year, closed unchanged at $9.346 per thousand cubic feet.

After hitting $103.95 in New York trading on Monday morning, crude oil pulled back to close at $102.45. In London, Brent crude oil futures rose 38 cents, to $100.48 a barrel.

Gold also reached a record after several days of large gains; it traded on Monday at $989.54 an ounce.

With oil setting fresh records, many analysts expect gasoline to approach $4 a gallon on average this summer. Gasoline prices have been rising sharply in recent days and have hit $3.16 a gallon on average, according to AAA, the automobile club. They are closing in on last year's record of $3.23 a gallon.

There is evidence that these high prices are finally causing consumers to cut consumption.

According to the latest government figures, released Monday by the Energy Department, gasoline demand fell by 1 percent in December 2007 from the previous year. Oil demand was nearly flat last year as well.

Gasoline accounts for about half of the total oil used in the United States, which consumes one in four barrels of oil produced worldwide each day. Most experts say the price of oil is not about to drop anytime soon. Saudi Arabia's oil minister, Ali al-Naimi, said crude prices were unlikely to fall below $60 a barrel because the cost of developing new supplies, from sources like Canadian tar sands, is rising.

"Therefore, a line has been drawn below which the price cannot fall," Mr. Naimi said in an interview published over the weekend by Petrostrategies, an industry newsletter in Paris.

Mr. Naimi's comments came as the OPEC oil cartel prepares to meet on Wednesday. It is expected to leave its production levels unchanged.

The oil producing group suggested last month that it might curb production soon to make up for a seasonal decline in oil demand. But with oil prices at current levels, analysts said members of the Organization of the Petroleum Exporting Countries would find it politically difficult to curb their output now.

Some analysts expect oil producers to trim their production informally to avert an oil surplus in coming weeks. Others say OPEC, which controls 40 percent of the world's oil exports, is being pulled apart by contradictory pressures.

"The market around the fringes is starting to fray," said Lawrence J. Goldstein, an economist at the Energy Policy Research Foundation. "Yet ironically, you are looking at triple-digit oil prices because the price is being set by nonphysical investors."

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