How Wall Street will kill the recovery

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Synopsis
Wall Street is taking much of its federal money and using it to again speculate in the oil market. **Fastest growing companies** | **MNCs expand tech R&D in India**

By Ed Wallace

Wall Street is up to its old tricks again.

One year later, one of the key excesses that led our consumer-based economy into an historic downturn is being abused in the exact same way that got us $147-a-barrel oil last summer. Worse, many in the media are again getting the facts wrong on oil prices and demand���as if the oil and gasoline price explosion of 2005-2008 never happened���as one look at last week's oil report will verify.

Forget what Cambridge Energy Research Associates reported on Oct. 13. By its calculations oil demand actually peaked in 2005 among the industrialized members of the Organization for Economic Cooperation, while in the U.S. alone oil usage has dropped by 2 million barrels a day compared with 2005. But remember these facts: As of this writing, U.S. supplies of refined distillates, including diesel, heating oil, and aviation fuel, are at a 25-year high. We have 29.56 million more barrels of oil in our inventories than we had the same week a year ago, and refined gasoline on hand is up 16.37 million barrels for the same period. And this does not include the 125 million barrels of oil that the Secretary General of OPEC says are being held offshore in tankers.

Skewing in Public In fact, the market is skewed by the high inventories of refined products. Last week, the Energy Information Administration showed that refinery utilization rates fell by over 4%, to 80.9%, yet oil jumped $2 a barrel on the news that our gasoline inventories fell by 5.2 million barrels.

That was the dark side of the futures market making its move: Oil should have fallen just because, according to the American Petroleum Institute, refinery crude runs fell by 511,000 barrels per day (validating that 4% drop in utilization). In short, refineries determine oil demand, and in that week demand for more oil was off

It is true that this time of year usually sees some refinery maintenance. But, as Truman Arnold trader Tom Knight wrote, "Though [refiners] say this is planned maintenance, we hear it is primarily motivated by very poor refining margins [and] the collapse of the sweet/sour crude spreads." Referring to "ongoing problems at the Delaware City [Del.] refinery," Knight gets the sense that this may be "the precursor to a permanent closure of that refinery." Basically, of course, overall demand for finished oil products is so weak and inventories so high that the "crack spread," or refinery profit, is virtually nil.

IEA Gave Us the Facts���Late This inconvenient truth is merely another strong indication that the retail market demand for refined goods doesn't come anywhere near justifying the market price for crude. Therefore, oil is back to being severely overpriced.

This assessment was validated on Oct. 7, when Forbes published these facts: Demand for diesel and heating oil has fallen by 9.5% in 2009; aviation fuel use is off by 3.3%; and the only positive sign was gasoline usage up by 6.2%. Of course, that's "up" compared to last year, when the price of gasoline soared past $4 a gallon during the peak driving season, severely depressing gasoline demand���but now we find problems with the 2008 reporting on energy.

We were given a clue in a report that the International Energy Agency issued on Sept. 10, 2008, a few months after our own record prices for fuel. In it a chart, headed "North American Oil Product Demand, Change 12-Month Moving Average," showed that gasoline demand in North America actually started falling in August 2007, fully four months before the now-official start date of the recession, while diesel demand started falling two months later.

Moreover, diesel demand turned decidedly negative in March 2008, as did gasoline demand that May. This means that all the time the energy reporting was claiming that gasoline and diesel prices were going though the roof for simple supply-and-demand reasons, real world demand was falling rapidly. The oil reality was exactly the opposite of what Wall Street and other investors were telling the media.

Your Tax Dollars at Work

So demand for finished products was falling, as was demand for oil importation, yet prices nearly doubled in that period for consumers and energy-intensive industries. It is said that the world economy's collapse was caused primarily by the events of last October on Wall Street, but the oil and finished products' demand decline showed that the economy was under stress for over a year before then.

This means it is still true that most recessions since the end of World War II have been preceded by a sharp rise in energy prices.

Today we are hearing all the same fairy tales we heard last year to explain why oil has gone from $33.87 a barrel this past winter to $79.54 as of this writing. Again, the first thing blamed is the weakening American dollar against foreign of 2005-08.

Forgetting Recent History

Another excuse given is that oil is following the equity market, but that's not how it's supposed to work. The futures market for oil is supposed to be governed by supply and demand, not react sympathetically to speculative moves in equities. In any case, it's been reported widely this year, starting with Der Spiegel's article on July 28, that the excess liquidity put into the system by central banks worldwide, money that was supposed to be put into consumer and business loans, has once again been used for speculation and quick paper profits in stocks and commodities, including oil.

As Washington irony goes, this is a new high-water mark: They've printed money to save our financial institutions, claiming it's there to stimulate a recovery. Yet much of that newly minted money is being used against consumers and small business owners. The money that's supposed to save them in new loans is instead increasing their energy costs through speculation, to the point of devaluing corporate earnings and personal incomes and prohibiting other purchases.

The sad truth is that if oil costs have more than doubled during a period when so little economic growth was taking place, you have to wonder how high the oil market will rise next year, when a real recovery has the chance of taking hold. In that statement lies the fact that this recovery will be stopped again.

A Tired Logic

In 1997, a financial crisis in Asia caused a local economic collapse that made itself felt in oil prices around the world. The worst devastation was limited to Thailand, Malaysia, Indonesia, the Philippines, and South Korea; the Mercedes dealership in Bangkok survived only by turning into a restaurant. And, although the U.S. and Chinese economies were rising swiftly that year, what happened to a few economies in Asia was still enough to drive the price of oil down from the mid-twenties range to around $10 a barrel, allowing gasoline to be sold in the States for 99�� a gallon. This past 12 months a far worse financial crisis has gone global, yet the oil market has acted as if these were boom years.

Is today's stock market divorced from economic reality? Probably. It is a certainty that oil is. We know that because those in the market are still putting out the same tired and incorrect logic that they used successfully last year to push oil to $147 a barrel while demand was plummeting.

Because oil is not carrying a market price that fairly reflects economic conditions and demand inventories, overpriced energy is siphoning off funds that could be used for corporate expansion, increased consumerism and, in time, the recreation of jobs in America. Moreover, as businesses everywhere de-leverage, we are watching family incomes fall dramatically. This puts even more pressure on incomes to pay for gasoline���not to mention the fact that buying gas with a credit card today will cost consumers more because of much higher interest rates than it did a year ago.

High energy prices started hurting the consumer economy back in August 2007, and oil prices had caused grievous damage by the summer 2008. And apparently we haven't learned a thing from that painful experience, because we are witnessing the exact same scenario unfolding today. If it isn't corrected quickly, rising energy prices will stop whatever recovery is now beginning dead in its tracks, and if oil climbs any higher it could easily run the economy off the rails next year. One has to wonder: What will Washington's plan be then?

Note to media: When refinery runs are down 4% that means refineries are using less oil. One should quit writing that's a good reason for oil prices to go up.

Ed Wallace is a recipient of the the Gerald R. Loeb Award for business journalism, given by the G. and R. Loeb Foundation, and is a member of the American Historical Society. His column leads the Fort Worth Star-Telegram's "Sunday Drive" section. He reviews new cars every Friday morning at 7:15 on Fox Four's Good Day, contributes articles to BusinessWeek Online, and hosts the top-rated talk show Wheels Saturdays from 8 a.m. to 1 p.m. on 570 KLIF.

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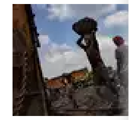
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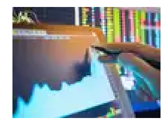
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