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Oil Rises 3%, but OPEC May Open Spigot

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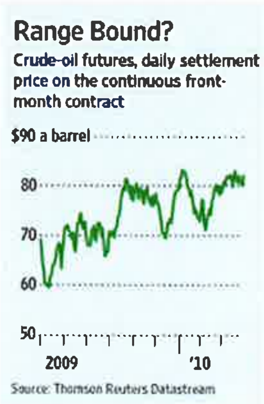
Crude-oil prices climbed Monday, gaining almost 3% in response to new evidence that the global economy is strengthening. But developments in recent days indicate that investors are wary about the future.



While traders bid crude futures up $2.17 a barrel to $82.17, the biggest gain in almost six weeks, prices again failed to push beyond the $83 level—the year's high reached in early January. That suggests broad uncertainty about whether the economic recovery is powerful enough to ratchet up demand.

Supply, meanwhile, may become more plentiful, another potential drag on prices. On Monday, the Organization of Petroleum Exporting Countries indicated that it is moving to boost production, demonstrating again its commitment to trying to keep oil prices from rising too high. And the closely watched relationship between current and future crude prices is starting to shift in a manner that indicates investors may be betting on surplus supply in the future.

The oil market has been stable since the second half of last year, as prices have largely remained in a narrow band between $69 and $83. That level is well off the highs above $140 a barrel that oil hit in 2008, before the financial crisis gained steam, but also well above the crisis lows of a year ago.

Recently, however, a move to the top end of that range had some traders anticipating a breakout move to a higher price. That reflected a belief that the economy was improving and growth in developing markets would drain what had been plentiful supplies.

But the breakout hasn't occurred. And traders have become less willing to pay a high premium to lock in supplies months down the road.

That can be best seen in the narrowing of the gap between the price of oil for immediate delivery and the price for future delivery—a sign that buyers think supply may be more robust than demand in the future.

"We clearly have two market views, the long-term bulls are losing some faith, but the short-term bulls are more bullish," wrote Ahmad Abdallah, an energy analyst with Gave-Kal, in a recent research note.

Typically, future prices of oil are higher than the current price—a state known in the commodity markets as "contango"—because there is less certainty that there will be a big enough supply of oil into the future.

The market still reflects that normal state. But the gap between the two is shrinking, causing some to speculate that it may invert, a phenomenon known as backwardation.

The gap, or spread, between the current futures contract and the contract for delivery in six months has been cut almost in half this year, from $3.17 to $1.62 at the close of U.S. trading on Monday, the narrowest since early October 2008.

The main reason, investors say, is the likelihood that supplies will be plentiful.

That belief was backed up on Monday when OPEC's secretary general, Abdalla Salem el-Badri, said member countries have restarted $45 billion worth of projects that had been mothballed due to the global economic slowdown.

The 35 drilling projects, slated for development over the next five years, amount to about five million barrels a day in gross pumping capacity. "If we see prices get out of control, OPEC will come in and stabilize the market," Mr. el-Badri said in an interview at a conference in Cancun, Mexico.

OPEC member states are sitting on more than six million barrels a day of spare production capacity, a healthy cushion to fill any unexpected supply disruption. Much of that capacity is held by Saudi Arabia, the world's biggest crude exporter.

Most states have said they prefer prices in a range of $70 to $80 a barrel. A senior OPEC Gulf delegate attending the Mexico meeting said that prices sustained for weeks above $85 a barrel would result in Arab Gulf members, like Saudi Arabia, pumping more crude to ease market concern about supply and basically ignoring the production limits that OPEC still has in place for each member state.

"They will leak more production into the market. They do not want prices getting out of hand," the senior delegate said.

The International Energy Agency in Paris estimates that oil-drilling investment globally is currently expected to come in at about $330 billion this year, a rise of about 7% from 2009 when investment collapsed almost 20%.

But IEA chief economist Fatih Birol cautions that the expected rate of investment this year is still about 10% to 15% below what was seen annually earlier this decade.

While prices have recently remained slightly below the year-to-date high, some observers still believe that rising demand will eventually result in irresistible pressure.

"The risk is to the upside," said Richard Ilczyszyn, senior market strategist at Lind-Waldock, a broker.

Monday's move higher in oil was related to weakness in the U.S. dollar "and also due to positive economic data from Europe and Japan," said Tom Bentz, analyst and trader with BNP Paribas in New York. Oil, like most other commodities, tends to rise on a weaker greenback as this makes dollar-denominated oil cheaper to buy for other currency holders.

Positive steps toward Greece managing its debt problems combined with more-upbeat economic data reports in Europe, Asia and the U.S. to allay some of the recent fears about a flagging global economy.

—Brian Baskin contributed to this article.

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