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## Federal Reserve Expansion Will Boost WTI, but OPEC Still Holds Cards

**Takeaway:** *The recent moves by the Federal Reserve to expand the money supply will give crude prices a double shot in the arm. On the one hand, these steps will likely raise inflation in the short term, encouraging investors to move toward real assets, particularly commodities. In addition, the dollar should also fall versus other currencies, encouraging more funds to shift from currencies into oil as a result.*

ESAI expects that the current move to bolster the money supply by the Federal Reserve will provide bullish support for oil prices into the initial quarters of 2011. Yesterday, the Federal Reserve finally provided detail about the quantitative easing actions that it opened the door to in late September. Since that initial hinting, expectations that the Fed would pump further cash into the economy has sent the value of the U.S. dollar down by 7% and the value of WTI up by more than \$11 per barrel. The announcement yesterday that the latest round of monetary easing will encompass the purchase of \$600 billion in assets and last through mid-2011 provides a bullish backdrop for WTI through the initial quarters of 2011.

The increased supply of cash into the economy will do two things; raise inflation expectations and pressure the U.S. dollar. Both suggest further support for oil prices through the first half of 2011. The additional money in the financial system, all else being equal, will chase a finite supply of real assets like oil and push prices higher. A correlation that was strongly evident in the large oil price rise after the Fed's initial round of quantitative easing in early 2009. The resulting rise in inflation expectations in the coming quarters will prompt greater investment into inflation sensitive assets like commodities. In an attempt to hedge against higher inflation, investors are likely to move greater percentages of their assets into inflation sensitive real-assets like oil. The expected increase in investor funds moving into commodity markets will provide further support for oil prices in the near-term.

With China easing its currency peg and less inflationary actions by the European Union, the U.S. dollar will remain under pressure in the near-term. This will translate into further support for WTI prices over

the same period. Overall, with the dollar weakening and inflation pressures rising, ESAI expects that the current move to bolster the money supply by the Federal Reserve will provide bullish support for oil prices at least into the initial quarters of 2011. The falling dollar will also reduce the cost of oil for consumers outside the U.S., which will bolster demand.

ESAI has maintained a generally moderate price view, bearing in mind the reassuring fundamental picture. OPEC spare capacity remains at relatively high levels over five million b/d. These potential additional volumes, along with OPEC's stated preference for a price near \$75 per barrel, has kept ESAI out of the \$100 per barrel camp. This week's moves by the Fed have led ESAI to raise its forecast for the coming months. However, OPEC will be less likely to allow prices to surge over triple digits in the current doubtful economic climate, compared to the bullish period in the first half of 2008. Any strong move over \$100 will almost certainly bring a production response from Saudi Arabia, Kuwait, and the UAE, helping to pull prices back down.