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OIL TODAY:
A SERIES OF ACTIONS AND EVENTS

This month's economic news focuses a good deal on what may be the most significant development of 2005 – the energy crunch and its effect on businesses and families worldwide.

The present situation has been in train for years, but what has happened in the recent past is eye-opening. The spot price for West Texas Intermediate first broke the $40 threshold in May, 2004. Five months later it was over $50 a barrel, and ten months after that, in August 2005, the price sailed past $60. Put another way, the price has effectively doubled in two years, from the $32 a barrel in December 2003 to today's $61.

What is more, there is no evidence to suggest that prices will ever return to the $40 level, and that probably holds true for the $50 level as well. Most forecasts call for increases, rather than significant declines.

The causes are many, but they boil down to one explanation – demand is growing much faster than production. In 2002, there were about 6 million barrels a day of excess production capacity. By 2003, that number had shrunk to 2 million barrels a day, and, during much of 2004 and 2005, there were only 1 million barrels to spare. Since world demand is now running over 80 million barrels a day, that excess production is simply not enough. (We saw what can happen to world supplies – and prices – when the hurricanes knocked out a large number of drilling rigs in the Gulf.)

Higher prices bring more production. Thus, the number of drilling rigs in the U.S. has gone up by over 18% from last year, to 1,480. But these kinds of increases are simply not adequate to meet the new demands worldwide. China (the subject of much that has appeared in these letters) is increasing its demand for oil at a pace commensurate with the growth in its economy, about 8% per year. It recently passed Japan as the world's second largest consumer of oil. India is another growing consumer. Thus, whatever new production can be brought on line, the prospect is for a continued squeeze on supply and little relief on prices.

We are all aware of the implications of high oil prices on the auto market and on home heating costs. October car and truck sales were at their lowest level since 1992. Light vehicle sales were off over 25% from October 2004 at both GM and Ford. Projections for increases in heating costs of over 50% have been made for this winter. Now, however, other industries are feeling the pinch. Energy surcharges are appearing in many sectors of the metals industries. European producers Corus and Arcelor have announced price increases to offset higher energy costs.

We have been through a large number of cost increases for steel production in the last two or three years, many of extreme volatility. Steel producers and their customers were forced to make accommodations, some rather painful, to address the problems those increases caused. But, in most cases, the increases were transitory and things returned to normal after a while. With energy costs, it looks as if we shall be burdened with the problem for the foreseeable future.

Here is some information on specifics:

- Scrap and Pig Iron. Prices for #1 dealer bundles and #1 busheling (Chicago) were down a bit this month, to $285 mt and $280 mt, respectively. Orders from Asia have picked up, and it now appears that exports of scrap with be at a record 13 million mt for 2005, an increase of over 16% from last year. One factor that could affect new year's scrap availability is the huge number of autos (between 300,000 and 500,000) that will have to be scrapped as a result of hurricane damage. The spot price for Brazilian pig iron (cif New Orleans) also declined last month, to $245 mt.

- Ocean Freight. The Baltic Capesize Index continued to climb, for the fourth consecutive month. It now stands at 4300, above the 3000 levels in the first half of 2003, but well below the 6000 to 8500 peaks we saw during 2004 and early 2005.

- Natural Gas. Here, the story reflects what is said in the main body of this letter. After some relief last month from the record Nymex contract prices of the month before, December showed another spike. In November 2004, the Nymex price for natural gas hit at record $8.75 per mcf but then receded in subsequent months. Over the past four months, that price has been $10.93, $13.86, $11.75 and $13.56.

- Exchange Rates. The dollar has weakened recently. As this letter is written, the euro is worth $1.20, up from $1.18 last month. The pound is now over $1.77, an increase of 4¢ from November. And the Canadian dollar is almost 87¢, up 3¢.

We want to close this letter with a deep note of gratitude to our customers and other friends in the steel industry. We understand that much of our business and the jobs of our workers depend on your good will towards Corey Steel. In the spirit of the season, all of us at Corey wish you, your families and your companies the happiest of holidays and the most prosperous of New Years.