

The Short View

By John Authers

Published: July 22 2008 03:00 | Last updated: July 22 2008 03:00

Did last week's 12 per cent fall mark the top for the oil price? Many believe so. This reflects wishful thinking but also some decent reasons for optimism on lower oil prices.

First, there is evidence that supply and demand in the oil market are beginning to behave as logic would predict when prices are high. US demand is falling, last week's figures showed, while supply is rising.

Each commodity has its own distinct transport and storage factors. But it is notable that other commodities are falling. The Dow Jones-AIG non-energy commodity index is down 12.5 per cent since its March peak while agricultural commodities, focus of great concern, are down 16.3 per cent. For these commodities, at least, deflationary economic forces appear to be having an effect.

Then there are technical measures, looking at trends in market prices. These are most useful when markets depart from their fundamentals, as oil appears to have done.

Recent behaviour looks very much like the bursting of a bubble - a sharp fall-back reversing an upward trend after the price had reached a peak and then failed to beat it. Traders watch such things closely, so such perceptions can be self-fulfilling.

Any optimism should be strictly tempered. The annual Caribbean hurricane season is under way. If it turns out to be even half as bad as 2005, the year of Katrina and Rita, then oil prices will rise from here.

Geopolitical concerns remain. Prediction markets slashed the odds of an attack on Iran in the past two weeks, but they are rising again.

And the oil price must fall much more before it finds a level that the world can live with, or relieves the pressure on the financial sector, which still looks likely to drag down share prices in the long run. But optimism on oil, if sustained, should help equities to continue to enjoy a temporary respite.