

Oil Prices and Drilling Show Strength

Oil prices declined steadily in the first half of this year, but escalating tensions in the Middle East have pushed them back up. West Texas Intermediate crude prices fell from a high of \$23.28 per barrel in January to \$16.26 per barrel in the second week of June, the lowest price since December 1988. Iraq's invasion of Kuwait pushed the price of West Texas Intermediate crude to \$28.05 per barrel at the beginning of August. Despite falling oil prices in the first half of the year, oil field activity has been fairly strong in both the nation and the Southwest. If higher prices are sustained, oil field activity should remain strong throughout the year.

The reasons for the steady fall in prices were a seasonal decline in demand and an increase in supply. Warmer temperatures generally reduce the demand for oil products in the spring, putting downward pressure on oil prices.

On the supply side, continued high production by the Organization of Petroleum Exporting Countries (OPEC) throughout the first half of the year caused a glut of oil in the market. A renewed commitment by OPEC to cut output to quota levels of 22.5 million barrels per day bolstered prices in the second half of July. The invasion of Kuwait further increased prices in August. Whether prices fall or rise depends on OPEC production and political stability in the Middle East.

Despite lower oil prices in the first half of the year, producer confidence in the oil market kept drilling activity strong (Chart 1). The number of well permit applications increased 10 percent in Texas and 56 percent in Oklahoma in May, and the rotary rig count has generally increased since January in Louisiana, New Mexico and Texas. The Texas rig count in June was 39 percent higher than in June 1989. Total well completions in Texas in the first half of 1990 were 18 percent higher than in the first half of 1989.

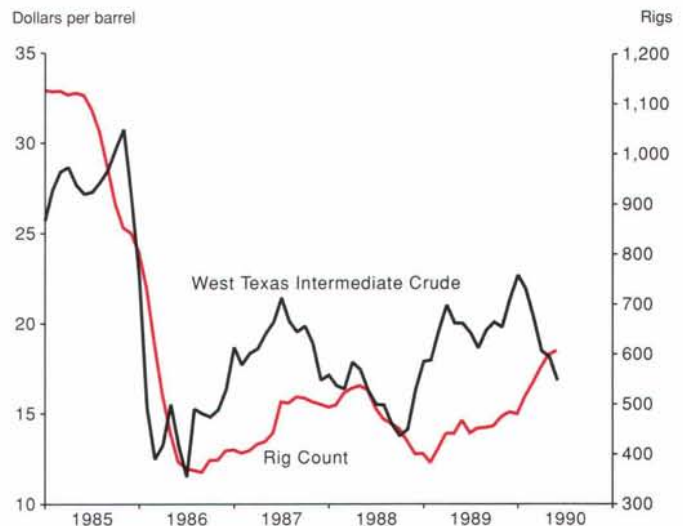
Some of the strength in drilling activity can be attributed to horizontal drilling. The number of horizontal well permits issued in Texas during the first half of 1990 was nearly six times greater than in all of 1989. Similarly, the number of horizontal wells completed in the first half of 1990 was 1.5 times the total number completed in 1989. Horizontal drilling in the Austin Chalk has been very successful lately, with flow rates 40 to 50 times the 10-barrel-per-day average for a Texas well.

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Chart 1
West Texas Intermediate Crude Prices and the Rig Count for Texas, Louisiana and New Mexico



Overall growth in world demand, the onset of declines in non-OPEC supply and promises of stable OPEC production at quota levels have fueled expectations of higher oil prices and have kept drilling activity high. If political instability in the Middle East continues to prop up prices, we should see stronger oil field activity in the nation and the Southwest.

—Mine Yücel

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