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Lessons from the Oil Market Come Home to Roost

The big news in energy today is the rising price of oil. Recently, the oil price flirted with the $45 per barrel level, and some analysts believe it will top $50 before the end of the year. This has implications beyond the gas pump, as it has strongly affected the stock market and could have an impact on the Presidential election. It also holds lessons for the uranium market.

In May 2000, we wrote a cover that asked the question, "Will Uranium Follow Oil?" At issue was not whether higher oil prices would immediately translate into higher uranium prices through a cause and effect relationship, but rather was uranium facing the same sort of market conditions that led to the price increase in oil. It seems that this has indeed been the case.

That earlier cover contained a quote about the then oil situation that has turned out to be prescient when it comes to uranium. The quote went as follows: "A major problem has been the illusion of knowledge. We thought that there was an oil glut and prices plummeted. In retrospect, the oil glut does not seem real. As a result, the industry missed two full investment cycles, which lowered production. The oil industry cannot be a just-in-time type of industry."

In many ways, you can substitute the world "uranium" for the word "oil" and that quote would describe the market in which we now find ourselves. One exception might be that we have missed only one full investment cycle in uranium, but the net effect is just as serious--if not more so--because the investment cycles are longer in uranium than in oil.

There was a logical explanation for the low prices at that time, which we provided in the cover. Basically, the small unfilled market that existed then was being met by inventories and other supplies that had no or low costs associated with them, and thus prices being paid bore no relationship to the level needed for replacement supplies. We noted that for these price levels to persist into the future, the same set of circumstances would need to prevail then. But we also observed that this would be "increasingly difficult" since unfilled require-ments were higher in the future and inventories were declining.

We also offered one further observation: "If there are problems in uranium similar to those in oil, they will not likely show up soon, because uranium has relatively long price cycles. In this regard, it will likely take some time for the present price cycle to play out." This too appears to be the case.

It is clear that uranium was not as plentiful as the low and falling price that existed in 2000 suggested. The subsequent price rise is thus quite understandable, and was largely foreseeable, as the earlier cover documented. A problem may continue to exist today to the extent that some market participants cling to the "illusion of knowledge," and seek to explain recent price behavior in terms other than the natural vicissitudes of markets.

Not only is the price cycle in uranium likely to last longer than the one in oil, but it has the potential to be much more severe. Uranium is the antithesis of a just-in-time industry, as long leadtimes are necessary to discover deposits and place them into production. Also, in the case of oil, rising prices eventually result in an

At the time the earlier cover was written, the uranium price was $8.70 and heading south, eventually falling to $7.10 by the end of the year. Base prices in long-term contracts were at their historic low point, and contract lengths were shrinking. Further, utilities were reducing their inventory levels. All of these developments pointed to the belief that there was a uranium glut in 2000.

economic slowdown that, in turn, reduces the demand for oil and causes price to cool off. In uranium, demand is much more inelastic, although consumers will cut back on consumption by reducing tails assays in enrichment contracts, however there are limits to this type of activity.

Figure 1. Ux U3O8 Price, 2000-2004