Replay, The Market is Well Supplied With Oil!

147th Meeting of OPEC

By John Hall

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The 147th. (Extraordinary) Meeting of the OPEC Conference

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After the last meeting, when OPEC announced that output would remain unchanged, I was initially hopeful that today we should see the position corrected. Instead, with many of us wondering why this meeting was actually taking place, the Opening Session was closed, presumably to shield the delegates from the intrusive and challenging questions that usually preceed the closed session and to enable the meeting and subsequent Press Conference to be concluded as quickly as possible. Furthermore, meetings usually follow a report from the Ministerial Monitoring Committee (MMC) which analyses information and data and prepares the intial report with recommendations for the Ministers to consider in the closed session. This did not take place and being an "extraordinary" meeting, there was actually no requirement for it to be held anyway. So, with no MMC and no Open Session, OPEC must have been sure well an advance what the outcome would be.

Today's meeting was held under the Chairmanship of its President, HE Dr Chakib Khelil, Minister of Energy and Mines of Algeria and supported by HE Abdalla Salem El-Badri Secretary General and the Press statement made was one of the briefest possible before the discussion commenced.

OPEC repeated that the market continues to be well supplied with oil, and that oil stocks have remained within their five year average and with the projected economic slowdown in the first quarter of the year, production was sufficient to meet demand. However, there was uncertainty at the effect of the potential downturn and therefore OPEC would follow the market carefully until the next meeting on 5th. March. In effect, OPEC is in a quandry. What should it do? Leading up to this meeting it had two options – do nothing or increase output. It chose to do nothing but, now, looking ahead it may even dare to think of reducing output in line with perceived lower demand.

In its approach today, OPEC was guarded and has postponed any serious discussion until March by which time it should have a clearer view of what it needs to do. In recent months it has been under considerable pressure to increase its output further but has argued that there has been no need. Last September it announced that the "quota" level would be increased by 500,000 bpd from 1st. November and at that time I had hoped for 1mbpd. Then, in December when some of us were very sure that there would be a further increase, the decision was taken to roll over. I had expected an increase of at least 500,000bpd and perhaps even 1mbpd particularly with the prospect of recession in the US and the EU. OPEC did not share this view and was asked today if, with hindsight, output should have been increased further last year. Again, it did not seem to agree.

OPEC through Saudi is under further pressure from the US to increase output. The Middle East is a very sensitive region, hence the geo-political tension festuring throughout and with many of the countries wary of outside intervention and particularly from the US, Saudi can not be seen to be acquiescing to pressure from the US against the collective wishes of OPEC. With visits in the last month from both President George Bush and Sam Bodman, US Energy Secretarywithin a week of each other, a more discreet approach is called for. OPEC has until March to weigh up the threat to OPEC from over production against the threat to consumers from under production. If the recession does fully materialise in the West, will it also impact on India and China and what will the effect be on oil demand?

When analysing the market supply position, it is worth looking at the individual countries which could also actually increase output if their own situations improved. In this context there are four main contenders – Iran, Iraq, Nigeria and Venezuela. Collectively they produce around 10.5mbpd.

Iran and Iraq where at war with each other for many years and their infrastructures suffered serious damage while Iraq has not recoverd from the US led invasion of 2003. With the right expertise and investement they could probably increase their joint output from around 6.7mbpd to 10mbpd. Meanwhile Nigeria and Venezuela are suffering from domestic issues with each losing around 1mbpd. Nigeria is of particular concern as the insurgency has recently escalated as new factions emerge. In the Delta region in which much of the oil exploration takes place, the local adminstration has failed to provide any benefits from the oil wealth to the local people and over time resentment has reached a critical level. The local administration may be at fault but one hopes that the central Government will intervene and bring about a resolution. The issue in Venezuela is simply the lack of domestic expertise and investment. Should these four countries rectify their individual issues their combined output could, in time, rise eventually from 10.5mbpd to 17mbpd.

The US consumes around 20mbpd while India and China consume take half that at 10mbpd. Yet with the Asian demand set to increase by 30% over the next five years, it is unlikely that a downturn in the West is likely to affect overall consumption dramatically and probably not beyong the usual seasonal fall in demand during the second quarter. US stock data is quoted each week and with crude stocks building in recent weeks, the market can take confidence that the overall level is not deteriorating seriously. Howevever, what should be appreciated is that the forward market is in backwardation which means that prices in the near future will be lower, so, why build up stocks today when the price is destined to fall? So stocks are not as high as they were last year although they must be maintained at an adeqate level for the future and not at higher prices.

The point that I made to Dr. Khelil and Mr. El Badri was that it is what OPEC says that counts and not what it does. If the market feels that OPEC will increase output, the price falls and conversely if the market believes that OPEC will reduce output, the price rises This undoubtedly gives OPEC some control over price but it maintains it is a “price taker” and not a “price maker”. When I asked what OPEC produces there was a delay while the number was worked out and from a supposed target level of 27.25 mbpd for the OPEC 10, and I say target as we are no longer using the word “quota”, the figure of 32mbpd was given to include Angola, Ecuador and Iraq which sounds a lot healthier than the 27.25 that is usually quoted. OPEC needs to get the message out more readily about what it is actually doing but we all know that when the price is high, and traditionally that is anything over $30, its members produce as much as they possibly can. Saudi perhaps is the exception, holding its output at around 9.5mbpd when it could take this to 11mbpd if required.

There was little reference to the weakness of the dollar today although when I discussed it with one delegate the view appeared to be that it can remain the reference price while sales transactions can be made in any other currency. This is very much a political issue particularly as the dollar has strengthened in recent weeks and the argument weakend but for those members who are particularly anti-US we can expect a return to this topic later on.

OPEC will remain under pressure to reduce prices from both the International Energy Agency (IEA) representing the OECD countries and the US Energy Information Administration (EIA), calling for more oil. It remains uncertain as to what OPEC will do but I hope that the idea of reducing output is quickly dismissed. Recession usually follows a period of higher energy prices and with the continuing migration of industry from the West – US & EU – towards Asia, India and China, I do not freel that global demand will be seriously affected. Nevertheless the price of any commodity that has trebled in dollar terms, although only doubled in Sterling and Euro terms, must have a detremental effect on economic growth of all consumers.

The "reasonable" price that OPEC has so often talked about is somewhere between $40 and $90 and it would be useful if it could be identified. Meanwhile OPEC continues to feel aggrieved at the level of taxation that some western Governments continue to collect from the taxing of OPEC oil and as one delegate mentioned to me, the record profit just announced by Shell was far in excess of anything they are able to achieve, while costs of producing oil continue to rise. So there are inbalances throughout the system and it would be unrealistic for us to believe that they can be rectified in the short term.

For now we shall continue to support our view to OPEC that prices should not be allowed to rise further and encouraged to fall back to more realistic levels between $60 and $70. We can hope for these levels but our short term forecast has to be more realisitc within the $80 to $90 range.

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Further information please contact:- John Hall +44 (0)7785 274530 or Damien Cox +44 (0)1403 269430
