International Monetary and Financial Committee

Seventeenth Meeting
April 12, 2008

Statement by Alipour- Jeddi
Organization of the Petroleum Exporting Countries

Statement by
Mr. Mohammad Alipour-Jeddi
Head, Petroleum Market Analysis Department
on behalf of the
Organization of Petroleum Exporting Countries (OPEC)

International Monetary and Financial Committee
Washington, D.C.
April 2008

OPEC would like to reiterate to the distinguished delegates attending the IMFC its continued commitment to maintaining oil market stability. This commitment was recently reaffirmed in the Riyadh Declaration for the Third Summit of Heads of State and Government of OPEC Member Countries, which highlighted the need to conserve, efficiently manage and prolong the exploitation of their exhaustible petroleum resources, in order to promote sustainable development and the welfare of future generations.

As part of its efforts to promote mutual understanding, OPEC attaches great importance to **institutional dialogue and cooperation** with producers, consumers and international organizations, including the IMF. The upcoming 11th International Energy Forum, which will take place in Rome on 20-22 April, represents the largest gathering of Energy Ministers from consumer and producer countries at any single event. The meeting provides an excellent platform to discuss energy issues as well as to exchange views on the challenges facing the oil market with a view to collective efforts to enhance overall oil market stability.

Although the pace of world economic growth and the rate of increase of global oil demand appear to have softened since the last meeting of the IMFC in September, **crude oil prices** have continued to experience strong volatility, with benchmark prices moving to record levels well above $100/b amid increasing price volatility. Over the last few months, fundamentals and financial market developments have been moving the oil market in opposite directions. How long this duality can continue is a key question facing the oil market in the coming months.

The widespread perception of a tight demand-supply balance, particularly during the high-demand winter season — one of the drivers behind higher prices over that period — did not materialise. OPEC's decision at its September Meeting to increase output by 0.5 mb/d, as of November, proved to be sufficient to both meet the needs of the market as well as to maintain OECD commercial inventories to levels close to the five-year average. Currently, crude oil inventories remain above the five-year average, leaving the market with sufficient crude stocks ahead of the spring season, although prices have continued to rise.

The sharp increase in crude oil prices over the last six months has coincided with a continuing decline in the value of the **US dollar** against other major currencies as well as a strong appreciation in commodity prices. More specifically, over the last year, the dollar has fallen by nearly 17% against the euro. In addition to making oil cheaper in other currencies, the weaker US dollar has also influenced oil prices via asset portfolio substitution as investors seek to hedge against inflation and the decline in value of the US dollar by switching directly to hard assets (typically oil, gold or other commodities) or indirectly via commodity baskets and index funds. This kind of tactical **asset substitutions** results in higher demand for paper-oil contracts. The flow of investment funds between oil and financial assets has exposed the oil market to volatility in non-oil asset prices. It has been suggested that poor returns in equity and corporate bond markets and better returns in oil and commodities have encouraged the inflow of speculative money into the commodity markets, contributing to higher prices and continued high volatility as witnessed in the significant price fluctuations seen in recent weeks.

While financial market dynamics have been a contributing factor to record highs prices, **oil-market fundamentals** point to a market which is currently well-supplied and the balance is expected to soften further due to lower seasonal demand in the coming months. Early indications of a highly probable end to the US **economic growth** cycle, which began in 2002, emerged in August 2007 as the extent of the turmoil in the subprime mortgage sector and the continuing decline in the housing sector became more apparent. The propagation of the initial subprime housing crisis to the wider financial markets has led to a general tightening of credit. Large sub-prime-related losses disclosed by financial institutions mainly in the US and Europe have eroded confidence in the financial markets, impacting equity and credit markets world-wide. Real estate prices have been declining in the US and in some European countries, further eroding household wealth, hence the ability to spend. The housing recession has spilled over to manufacturing, aggregate demand, and the labour market, with the the employment picture clearly deteriorating at the end of last year.

A broad-based US economic slowdown and a much higher risk of recession are bound to have significant ramifications for the rest of the world. Lower growth rates are already being registered in Europe and in Japan. There is increasing empirical support for a general economic slowdown in OECD. Downside risks to the world economy have increased considerably since the fourth quarter of 2007. World GDP growth rate is expected to be lower than any year since 2003. Current conditions point to reduced incremental oil growth and have already resulted in a change of perception towards a period of softer oil demand.

The depth and duration of the US downturn will depend on the success of the ongoing US monetary easing in restoring confidence in the financial markets, the willingness of banks to extend credit, and the ability of the private sector to get financing. The Federal Reserve Board's aggressive monetary easing may still have some way to go but options are increasingly limited due to rising inflationary expectations. At this juncture, policy-makers hope that the fiscal stimulus package will be able to induce higher private consumption expenditures in the second half of 2008.

The effect of slower growth in the US and in OECD countries on the economic performance of the emerging economies will largely depend on the degree of spillover to the rest of the world from a slowdown in the US. The initial projections indicate that Developing Countries, including China and India, are expected to grow at a robust pace, although below the rates achieved in 2007. However, this assumes that these economies are significantly decoupled from US growth; a view that is likely to be tested over the course of the year.

Turning to the world oil market, **global oil demand** is expected to grow at 1.2 mb/d in 2008, at the same level as in the previous year. The downward risks for oil demand this year will come mainly from the ongoing economic slowdown; weather-related factors; and the negative effect of high oil prices, particularly on transportation fuel demand, although estimated short-run price elasticities are very low.

The initial forecast for 2007 **non-OPEC supply** growth underwent significant revisions to end the year at 0.6 mb/d from an initial forecast of 1.4 mb/d. The main reasons behind the sharp downward revisions were project delays, longer- and deeper-than-expected maintenance, bad weather, technical problems, rising service costs, underperformance in some giant fields and unexpected outages. In 2008, non-OPEC supply is expected to face many of the same challenges as in the previous year with declines in mature fields and growth reliant on new projects coming onstream in areas with difficult operational conditions. As a result, the forecast for 2008 non-OPEC supply growth now stands at 0.9 mb/d; however, first quarter performance shows lower than expected growth.

The tightness in the **downstream** appears to be gradually easing as capacity expansion projects and a lighter maintenance schedule are expected to allow more refined products to reach the market. In the second quarter of this year, scheduled refinery maintenance is expected to be around

500,000 b/d, compared to last year when planned and unplanned outages amounted to as much as 1.5 mb/d. An expected 150,000 b/d increase in ethanol production should also ease gasoline supply concerns during the driving season. These developments indicate that product markets this year should be less supportive of crude oil prices than in previous years.

The projections for 2008 indicate that the growth in non-OPEC supply plus OPEC NGLs and non-conventional oil (1.4 mb/d) will outpace world oil demand growth (1.2 mb/d). This would result in a **demand for OPEC crude** that is lower than current OPEC production of 32.1 mb/d. With latest economic data pointing to a potential recession in the US, oil demand growth is unlikely to be higher than projected. At the same time, early indications clearly point to a well-supplied market. OECD commercial stocks have risen sharply in January to stand 48 mb above the five-year average and preliminary data indicate that stocks could have risen to as much as 60 mb above the five-year average in February. Over time, these gains should help to alleviate the impact of speculative activity on the market.

Despite expectations of softer fundamentals, increasing downside risks and the approach of the low demand season, OPEC Ministers agreed at the most recent **Ministerial Meeting** in March to leave production levels unchanged to support market stability. Although the next scheduled Ministerial Meeting is in September, OPEC Members will continue to closely monitor ongoing market developments and as always stand ready to take the necessary measures in line with their commitment to market stability.

Moreover, OPEC Members have been undertaking the enormous **investments** needed to ensure that supply is sufficient to both meet future demand as well as to provide an adequate cushion of spare capacity. These investments have taken place despite the considerable uncertainties regarding the demand for OPEC crude, which according to the OPEC's *World Oil Outlook*[*] could range as high as 9 mb/d by 2020. OPEC welcomes efforts to reduce demand uncertainties, including greater transparency on energy policies in consumer countries, which should help ensure timely investments over the long-term.

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[*] Released for the first time in 2007, the World Oil Outlook provides the Secretariat's long-term forecasts for the global energy market. The publication, which will be updated annually, is available at www.opec.org. Hard copies upon request.