International Monetary and Financial Committee

Thirteenth Meeting
April 22, 2006

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Organization of the Petroleum Exporting Countries
Statement
by OPEC Secretariat

to the
International Monetary and Financial Committee
Washington, D.C.

April 2006

OPEC would like to take this opportunity to assure all delegates attending the IMFC of its continued commitment to maintaining oil market stability, at price levels consistent with healthy economic growth.

Since the last meeting of the IMFC, oil prices have moved higher, with the OPEC Reference Basket having risen above $63/b in mid-April. This price rise occurred despite the fact that the market continues to be well-supplied, with OPEC Member Countries’ production having averaged 29.6 mb/d in March. The healthy situation on the supply side is further demonstrated by OECD crude oil inventories, which are at comfortable levels both in absolute terms and in days of forward cover, while US commercial crude oil stock levels have reached their highest levels in eight years.

These current, high inventory levels show to what extent the market has succeeded in recovering from the disruption in crude and product supplies following the hurricanes in the US Gulf of Mexico last year. This was thanks to the collective measures taken by both consumer and producer countries, including an emergency release of crude and product stocks on the part of the IEA followed by OPEC’s offer to make available its spare capacity of around 2 mb/d.

Last year also underlined the continued resilience of the world economy, as growth was substantial, and rates of core inflation remained under control despite higher oil prices. It is estimated that since 2002 the impact on global GDP of the rise in oil prices has been less than 1%. In 2006, OECD economies are expected to see little impact, as financial conditions remain accommodative, and solid increases in business and household incomes should permit the advanced economies to absorb higher costs. While the impact on developing countries is varied, the healthy momentum of world trade and strong commodity prices can be expected to support growth in most economies. In some cases, the removal of fuel subsidies has pushed up inflation, and poorer economies may suffer from increased balance of payments deficits. In this regard, OPEC is concerned that higher oil prices may affect the prospects of developing countries,
and will continue to closely monitor developments. Globally, the world economy is expected to continue its sustained growth in 2006, at a rate similar to that of 2005.

Following the slowdown seen at the end of 2005, oil demand growth is expected to rebound by 1.4 mb/d in 2006, above the average of the last 20 years. The main uncertainties concern the demand forecasts for the USA and China: The USA may continue to experience a weaker growth rate, similar to the one seen in recent months, which resulted from lower demand attributable to the warm winter and high energy prices. In China, however, growth could rise more than expected, following last year’s sharp drop in demand, which was due to improvements in the power generation sector.

On the supply side, non-OPEC production is expected to rebound from last year’s disappointing performance to reach 1.4 mb/d, with the higher trend expected to continue in the near term. The most significant downward risk on the supply side in 2006 continues to be the rate of recovery of production from the US Gulf of Mexico.

The picture on the products side remains tight, given the persistently low levels of refinery spare capacity and more stringent products specifications in the USA. As a result, any shortage caused by technical or logistic problems will continue to have a significant impact on the global market, affecting products prices and, consequently, crude oil prices. Furthermore, the planned phasing out of MTBE, and increased use of ethanol as a blending component, may exert more pressure on the gasoline market, in particular during the summer driving season, which will coincide with the introduction of ultra-low sulphur diesel in the USA.

So far in 2006, the market has been characterized by persistent volatility, with crude oil prices having fluctuated by as much as $10/b. At times the market’s attention is captured by news of unexpected supply outages or geopolitical concerns; then an inventory report is released, reminding the market that physical supplies, particularly of crude oil, continue to exceed demand. Unfortunately the upward rising trend indicates that healthy market fundamentals have been unable to outweigh fears of possible future supply disruptions. To further reassure the market, OPEC has maintained production at a high level, despite the expected seasonal drop in demand in the second quarter.

Since 2004, the traditional approach of using oil inventory levels to assess the relative tightness of the oil market, and thus oil price trends,
has been neither accurate nor effective. Despite the continued increase in inventory levels in response to OPEC’s sustained high production, prices have continued to rise, due to a number of factors, mainly persistent downstream bottlenecks, the perception of upstream constraints and ongoing geopolitical concerns. This has fed speculative cycles and increased activity in the futures market, as is reflected by the significant growth in the volume of open interest over the last three years.

As the evolving market situation has eroded the effectiveness of traditional market indicators, there is an urgent need to identify additional indicators that exhibit a more robust relationship with price behaviour, and could, therefore, prove a more reliable indicator of current market direction.

Another key challenge facing the oil market relates to the uncertainties surrounding future demand for oil in general, and for OPEC oil in particular. Areas of uncertainty concern future world economic growth rates, consuming countries' policies, technological developments and future non-OPEC production levels. These uncertainties give rise to a broad range in the estimates for demand for OPEC oil in the years to come, thus greatly complicating the planning for appropriate and timely investments in OPEC Member Countries, and consequently increasing the risks associated with both under- and over-investment. In this regard, OPEC and the IEA are jointly organizing a workshop, to be held next month, to consider the key issues and uncertainties for world oil demand in the coming years.

In the meantime, OPEC Member Countries have been steadily increasing crude production capacity, in order to meet expected growth in demand, not only for the current year, but also for the many years to come. By the end of 2006, OPEC production capacity is expected to have reached 33.3 mb/d, an increase of 1.2 mb/d, while during the period 2006-2010, OPEC production capacity is expected to grow by 5 mb/d.

It should be emphasized that the need for appropriate investment is not confined to the upstream sector, but also extends along the entire supply-chain, particularly in the downstream sector. Given current trends, tightness in the downstream sector can be expected to remain a potential source of volatility, especially if the necessary investment in the refining sector is not undertaken in a timely manner. In this context, OPEC Member Countries have embarked on ambitious programmes of downstream investment, in an attempt to relieve part of the expected market tightness in the coming years, and in the hope that consumer
countries and the oil industry in general will rise to the challenge, and carry their share of investments. This week ministers from producer and consumer countries and high representatives from the industry and from international finance are meeting in Doha, at the 10th International Energy Forum, for in-depth discussions regarding the world’s energy issues.

In light of the above challenges, OPEC Member Countries will continue to closely monitor the market, and stand ready to make the timely decisions needed to ensure adequate supplies consistent with robust economic growth. In the pursuit of market stability OPEC continues to strengthen and deepen its cooperative efforts with other stakeholders in the oil industry, in the strong conviction that only through increased dialogue and shared responsibility can the challenges posed by the oil industry be successfully faced.

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