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

International Monetary and Financial Committee
Washington, D.C.

April 2010

OPEC would like to assure the distinguished delegates to the IMFC of the Organization's ongoing commitment to **oil market stability**, ensuring a regular supply of petroleum to consumers at price levels which are equitable not only for the world economy and consumers but also to provide adequate future supply. Moreover, OPEC's ongoing efforts to reduce market imbalances have also helped to reduce price volatility.

A steady stream of more positive macroeconomic indicators has lifted sentiment about **world economic prospects** in recent months. Manufacturing continues to pickup worldwide throughout the developed and developing world, while services have also been catching up, although at a more gradual pace. International trade has also begun to improve in recent months, with Asia gaining from the IT trade revival. World economic growth will rely considerably on the expected stronger growth in developing and emerging markets given the more modest growth expected in OECD. China, which has been a main motor of world growth as imports surge, is seen to account for around one third of global growth this year, mainly supported by a massive fiscal stimulus package. Growth in India has also surprised on the upside.

At the same time, within OECD, there are mixed signals. Positive developments include early signs of improvement in the US labour markets, as well as rising consumer sentiment which has been reflected in improved retail sales. The US savings rate has also moved up, although it appears to have stabilised. In Japan, the recovery remains dependent on exports as the main driver of growth but stimulus measures are still needed. In contrast, growth in the Euro-zone appears to have lost some momentum and the region is burdened by sovereign debt issues and falling retail sales.

The economic optimism has also boosted investment flows into equities. **Equity markets** worldwide recovered considerably from the lows seen in March 2009. It is important to note that since the onset of the global financial crisis in October 2008, benchmark oil prices have begun to show a strong correlation with equities, which amounting to a strikingly high level of 0.91 over that period.

The bullish economic news has increased interest for investing in all commodity markets, including oil. Indeed, on 13 April, a record high 2.5 billion barrels of 'paper oil' traded on the world's two main **futures exchanges** – the equivalent to roughly 29 times the volume of daily global oil consumption. The surge in investment flows points to the need for proper oversight and regulation to prevent a repeat of the destabilizing price fluctuations seen in 2008. Moreover, speculators on the New York Mercantile Exchange (Nymex), as reflected by money manager activity, have extended net long positions in the crude oil futures markets to record highs. The strong co-movement between WTI prices and net long positions on the Nymex demonstrates the influence that **speculative activity** has on the oil market and prices.

Indeed, since the beginning of 2010, **crude oil prices** have fluctuated within a stable range of around $70-80/b. However, with the increased optimism in recent weeks, prices broke out of this range to move higher reaching an 18-month high of more than $86/b on 6 April before easing to the lower $80s/b over the next days. The key question now facing the oil market was whether the $70 – $80/b is sustainable over the coming months. The main factors capping prices have been the slower-than-expected economic recovery, rising debts, weaker-than-expected demand growth, the energy policies of the consuming countries, excess crude and product inventories both onshore and offshore, and higher spare capacity in both the upstream and downstream sectors. As for factors setting a floor on the price range, these were mainly to do with the weak outlook for non-OPEC supply, the higher marginal cost of production, effective role of OPEC in balancing the market, and geopolitical concerns, which have been amplified by speculative activity. At the same time, developments in the wider financial markets, particularly in equities and the value of the US dollar, have impacted the market in both directions, although the correlation between WTI and the $/euro rate which has held in the past two years, has weakened since the start of 2010.

Amid the growing optimism, it is important not to overlook **potential risks**. The financial sector has made some strides but it remains uncertain whether it has recovered enough to make positive contributions to growth. Foremost for the success in maintaining the nascent economic recovery until self-sustaining growth takes hold, will be the timing of exit policies. In both developed and developing countries, fiscal and monetary tightening will have to begin later this year or, at the latest, in 2011. Within the OECD, a major dampening factor to stronger growth, apart from high unemployment, which will restrain private consumption, are the looming fiscal imbalances. Inflation remains subdued in OECD countries, but in emerging markets, inflationary pressures have become more evident. Particularly in India, food inflation has reached high levels and prices are also rising in China, where strong growth may be leading to a possible overheating of the economy. China's central bank has already raised bank's reserve requirements twice in 2010 in what is seen as a first step in tightening monetary conditions. In the US, early signs of tightening include a small rise in the discount rate but the target for benchmark federal funds rate may be maintained at the current low levels until evidence of self-sustaining growth is clearly evident.

Overall, the world economy is expected to grow by 3.5% in 2010. A key contribution is seen coming from China which is expected to expand by 9.5% while India is forecast to grow by 7.1% in 2010. In contrast, the OECD region is expected to see more moderate growth of only 1.9%.

As result of the recovery in the global economy, **world oil demand** has halted its decline from the last two years. In 2010, global demand is projected to increase by 0.9 mb/d. However, this is still well below the five-year average for the period preceding the onset of the global recession, mainly due to increased efficiency and substitution away from oil to biofuels and natural gas. This shift appears to be the result of intensified and coordinated policy initiatives in the OECD countries. Emerging markets are also being encouraged to follow a similar approach, although this might proved to be challenging. With OECD appearing to continue the decline seen since 2006, all the expected growth in oil demand this year is projected to come from the non-OECD region led by Asia. It should be noted that there is still large uncertainty surrounding this forecast as the data so far does not indicate a noticeable pickup in global demand. The main areas of uncertainty remain the US and China.

After the poor performance seen in 2008, **non-OPEC supply** has been improving over the past two years and growth is expected to continue in 2010. However, there are risks to the supply forecasts, mainly from Russia and Canada. Non-OPEC oil supply is expected to increase by 0.5 mb/d over the previous year but remain below the five-year average. The main contributors to the growth in 2010 are expected to be Brazil, the US, the Caspian region, Russia and Canada, while the United Kingdom, Norway and Mexico would continue to see declines as a result of losses from their mature fields. The continued increase in the share of **OPEC NGLs** and non-conventional oils is now slightly higher than non-OPEC supply growth. **Biofuels** have also showed steady gains, despite growing concern over their adverse effects on prices and availability of food as well as on the environment.

Regarding **petroleum inventories**, the excessive overhang seen in total OECD commercial stocks had decreased from its peak in March 2009. At that time, it stood at around 200 million barrels, but then fell to around 60 million barrels in December before rebounding to stand close to 140 million barrels in March. Inventories are likely to build further with the end of winter and ongoing seasonal refining maintenance which has reduced crude runs.

After reaching an exceptional high 160 mb, crude and oil products in **floating storage** have declined as a narrowing contango has made it less profitable to store oil on tankers. Still, floating storage remains at a high level of around 100 million barrels.

In recent years, inventories have steadily increased in the emerging markets, particularly China. Since January 2008, the accumulative increase in crude oil stocks in China reached close to 100 million barrels. China has long-term plans to move towards the OECD standard of 90 days of forward consumption by 2020.

There had been a lot of discussion concerning the current contango in the **forward structure** that began in 2008. The narrower contango has raised questions as to whether the market is heading towards backwardation. However, market indicators do not support the likelihood of a switch to backwardation. The prevailing low cost of storage onshore, which is still below the current contango level should encourage further builds in crude stocks. The rise in crude inventories, particularly in the US, does not support a switch to backwardation, especially given the well-supplied spot market.

In the **downstream** sector, developed and emerging markets are showing different trends. In the OECD, throughputs have fallen, due to weak demand, whereas in China they have increased. With completion of maintenance in the Atlantic basin in May as well as a lack of robust demand for major products, product market sentiment is not expected to strengthen further in the future to encourage refiners to change their current low run strategy. This situation would not provide sufficient support for crude market fundamentals in the coming months.

In light of the uncertainty in the macroeconomic environment and its potential impact on oil demand, OPEC Ministers at the **156th Meeting of the Conference** in Vienna agreed to leave production levels unchanged. OPEC crude oil spare capacity of more than 6 mb/d in combination with higher inventories was seen as more than sufficient to accommodate any strong rise in demand. Ministers will hold their next Meeting to review the oil market in October 2010.

As has been seen in recent years, the emergence of **oil as an asset** class has considerably transformed the oil market. Prices are now exposed to volatility in the wider financial markets and, as a result, have experienced a higher level of volatility unrelated to fundamentals. This represents a significant impediment to market stability and to ensuring adequate and timely investment flows into the energy sector. Going forward, the growing impact of the financial markets on crude oil prices and volatility, along with the outcome of efforts by consumer governments to increase oversight and enhance regulation, will be a key factor influencing oil market stability.

Recent developments clearly point to the importance of **enhancing oversight and regulation in the financial oil markets**, and efforts so far represent positive steps in the right direction. The recent **IEF meeting in Cancun, Mexico**, held on 30-31 March 2010, underlined the importance of approaching the physical and financial markets’ linkages and energy market regulation in a well-coordinated way. Also during discussions, there appeared to be a consensus that prices around the current range are essential to promote adequate investment without hindering the economic recovery.

This year marks the **50th anniversary of OPEC**. The Organization's accomplishment over the last half century confirms its tireless efforts to fulfil its key objectives including ensuring efficient and regular supplies of petroleum to consumers. OPEC is fully cognizant of the fact that the need to ensure a stable and harmonious oil market is of great benefit, not only to the oil-producing nations who rely heavily on hydrocarbon revenues for their economic development but also to the consumers who can be secure in the knowledge that crude oil supplies will be available at fair and reasonable prices. Since its founding, the Organization has been fully aware that forming a common understanding with the other important oil industry stakeholders is the best way forward for establishing a market that is both stable and sustainable. As OPEC's slogan 'Supporting Stability, Fuelling Prosperity' for its 50th anniversary suggests, the Organization's policy decisions in the years ahead will continue to be aimed at creating harmony and stability in the international oil market for the benefit of the producers, the consumers, the investors and the global economy at large.