THE OIL MARKET, OPEC AND THE MIDDLE EAST: ECONOMICS AND POLITICS

Manouchehr Takin*

* International Oil & Energy Consultant
E-mail: manouchehr.takin@gmail.com. Tel: +44 (0) 7896 809 365
OUTLINE OF PRESENTATION

• OPEC & the Middle East – a global perspective

• A briefing on OPEC – past and present

• Oil price cycles

• Supply shortage led to oil price jump (2003-2008). Excess supply led to oil price collapse (recent years)

• Current market situation – need for global diplomacy

• General discussions on OPEC
OPEC OIL RESERVES & PRODUCTION COMPARED WITH REST OF THE WORLD (2015)

Source: Oil & Gas Journal
MIDDLE EAST OIL RESERVES & PRODUCTION COMPARED WITH
REST OF THE WORLD (2015)

Share of the world total

Source: Oil & Gas Journal
RESERVES AND PRODUCTION POSITIONS OF OPEC AND THE MIDDLE EAST

• OPEC and the Middle East contribute respectively 40% and 31% to world oil production.

• Their production is low in proportion to the size of their reserves (OPEC 73% and the M East 48.5% of world oil reserves).
CRUDE OIL RESERVES OF OPEC MEMBER COUNTRIES END 2015
Total 1,206 bn bbls

Source: Oil & Gas Journal
CRUDE OIL PRODUCTION OF OPEC MEMBER COUNTRIES 2015
Total 31.2 MMBPD

Source: Oil & Gas Journal
OIL PRODUCTION WITHIN OPEC

• Saudi Arabia has about 1.5 mbpd spare production capacity.

• The ‘rich’ countries (Saudi Arabia, the United Arab Emirates, Kuwait, and Qatar) contributed 51.5% to total OPEC oil production in 2015.

• Thus the strong bargaining position of Saudi Arabia and the other ‘rich’ countries within OPEC policy negotiations.
ABOUT OPEC

• OPEC was established in 1960 in response to the excesses of the oil concessionaires in the first half of 20th century.

• The Organization was expected to provide a stronger bargaining position in negotiating with the oil companies.

• A mission of OPEC:
  To coordinate and unify the petroleum policies of its Member Countries and ensure the stabilisation of oil markets in order to secure an efficient, economic and regular supply of petroleum to consumers, a steady income to producers and a fair return on capital for those investing in the petroleum industry.
MORE ON OPEC

• OPEC began to set the price of oil independently from the oil companies in 1974, but since the mid-1980s the price of oil has been left to the ‘global supply and demand’ and ‘market forces’.

• However, OPEC has tried to fine-tune its production in order to stabilise the oil market, avoid price fluctuations and defend the main source of the national income of its Member Countries.

• In general, OPEC policy actions have been reactive to the changing market conditions.

• OPEC has cut its production when price has fallen and has also increased its production when the price of oil has gone up.
THE PRICE OF OIL

• Is a function of market fundamentals and the (im)balance between the flow of oil into and out of the market.

• Economic growth soon leads to higher oil demand and vice versa in the case of economic slow-down and recession.

• Oil supply, however, is almost inelastic in the short-term.

• When a field-development project is completed, oil production commences irrespective of the market conditions at that time. Deep offshore fields, oil sands and other mega projects, take several years to go on stream.
OIL PRICE CYCLES

• High price of oil provides revenue for the industry and an increase in upstream investments. The opposite happens when price is low.

• With a supply lead time of several years ‘market imbalance’ and oil price cycles are inevitable.
THE MAIN CULPRIT: SUPPLY

• The price of oil rose from $20 to $147 between 2004 and 2008 because of
  • Supply Shortage

• The price fell to nearly $30 by end 2008-early 2009 - OPEC cut its oil production and price improved, but since then:
  • Supply Excess

• Unexpected reversal of OPEC policy in November 2014 – previous policy of cutting OPEC production and defending a high oil price was:
  • Not Sustainable
WHY WAS THERE A SUPPLY SHORTAGE IN THE MID-2000S?

Price of oil had been $15-$25/bbl since 1980s. It collapsed to $10 in 1998.
THE MAIN REASON FOR THE SUPPLY SHORTAGE

• Industry lost confidence in the oil price outlook and there was under-investment in world upstream from 1998 till about 2003.

• Price began to increase and companies started investing since 2004, but with the long lead-time of operations, supply could not meet growing world demand for oil, e.g. in China.
SHORTAGE WAS REVERSED INTO EXCESS SUPPLY
(Market imbalance continuing till today)

• Economic slowdown in 2008 resulted in a decrease and then slow growth in world oil demand. However, supply growth continued from ongoing projects coming on stream everywhere, in particular the US (shale & tight rocks).

• OPEC decreased its oil production to balance the market, price improved, but OPEC policy was not sustainable.

• Ministers (27 November 2014): OPEC will no more lower its oil production. The oil market weakened further.
REVERSAL OF UNITED STATES CRUDE OIL PRODUCTION DECLINE
(decrease since 1970 has reversed into increase since 2009)

Source: US Dept of Energy,
REVERSAL OF UNITED STATES CRUDE OIL PRODUCTION DECLINE
(decrease since 1970 has reversed into increase since 2009)

Source: US Dept of Energy,

3,980: Sep 2008
4,737: Oct 2008
5,234: Feb 2009
6,094: April 2015
9,262: December 2015
9,078 Week to 4 March 2016
UNITED STATES WEEKLY CRUDE OIL PRODUCTION
(January 2014 – 4 March 2016)

Source: US Dept of Energy

Week to 4 March 2016:
9.078 mbpd
SOME CONSEQUENCES OF OIL PRICE COLLAPSE

• Generally **beneficial to the world economy**.

• **Serious budgetary constraint** and economic/social crisis for all oil exporting countries – OPEC and Non-OPEC.

• **Examples of job losses:**
  250,000 jobs lost world energy industry (114,000 in the US) since mid-2014 to Jan 2016.
  65,000 jobs lost in UK North Sea 2014-January 2016.
  20,000 jobs lost (80,000 staff before price fall) in Halliburton.
  20,000 (2015), 10,000 (2016) Schlumberger 20,000 2015, 10,000
  6,000 (Technip July 2015)
  6,500 (Shell July 2015)
  42 US shale oil drillers became bankrupt in 2015

Sources: IEA, EIA, Oil & Gas Journal, Financial Times, BBC World News TV, City AM (London) and others
IMPACT OF OIL PRICE COLLAPSE ON OIL INVESTMENTS

• Global oil exploration and production capital expenditure fell by 24% in 2015 and is expected to fall by 17% in 2016 – first time since 1986 of fall in two consecutive years.

• Fall in investment in world oil industry:
  • $380 bn of projects have been postponed so far. There is risk that oil and gas projects worth $1-1.5 tr could be cancelled.

Sources: IEA, Oil & Gas Journal, Goldman Sachs, Financial Times and others

• The above cuts will result in future shortage of oil, rise in the price of oil and yet another ‘cycle’.

Sources: IEA, Goldman Sachs and others.
MORE ON SAUDI ARABIA

• **The Kingdom** is loosing **$0.75 bn** oil export revenue per day.

• Government sold **$27 bn billion of bonds** to cover its deficit in 2015.

• GDP growth **3.3% (2014)**, **3.1% (2015)**, **1.9% (2016)**.

• Budget deficit **$98 bn (2015)**, **$87 bn (2016)**.

• The Kingdom’s net foreign asset reserves **$732 billion (end 2014)** down to less than **$600 billion (February 2016)**.

• There is speculation on the value of Saudi Riyal.

• The military interventions in **Yemen** and **Bahrain** are further draining the Kingdom’s resources.

**How much longer** can Saudi Arabia sustain this oil policy?

## ANNUAL WORLD OIL SUPPLY-DEMAND DATA (mbpd)

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016*</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Total world oil demand</td>
<td>88.1</td>
<td>89.1</td>
<td>90.4</td>
<td>91.4</td>
<td>93.0</td>
<td>94.2</td>
</tr>
<tr>
<td>(b) Total non-OPEC supply and OPEC NGLs</td>
<td>57.8</td>
<td>57.7</td>
<td>59.2</td>
<td>61.7</td>
<td>63.2</td>
<td>62.7</td>
</tr>
<tr>
<td>(a)-(b): 'need for OPEC oil'</td>
<td>30.3</td>
<td>31.4</td>
<td>31.2</td>
<td>29.8</td>
<td>29.7</td>
<td>31.5</td>
</tr>
<tr>
<td>OPEC crude production</td>
<td>29.8</td>
<td>31.9</td>
<td>31</td>
<td>30.8</td>
<td>31.9</td>
<td>32.4**</td>
</tr>
<tr>
<td>OPEC production less 'need for OPEC oil'</td>
<td>-0.5</td>
<td>0.5</td>
<td>-0.2</td>
<td>1.0</td>
<td>2.1</td>
<td>0.8</td>
</tr>
</tbody>
</table>

* Estimates

** Average January-February 2016

Source: OPEC
THERE HAS BEEN EXCESS SUPPLY OF OIL FLOWING INTO THE WORLD MARKET SINCE 2014

• Excess supply flow is continuing and oil storage spaces around the world are almost full. At current production rates, stocks will keep building at 1.1 mbpd in 2016.

• In order to balance the market, oil supply should be reduced, but it will still take some time for the world oil inventories to fall to ‘normal’ operating levels.

• There is need for production cuts by OPEC and/or Non-OPEC – this requires international diplomacy.

Sources: IEA, Financial Times, OPEC and others.
DIPLOMACY IN 1986 & 1998 – in 2016?

- **1986**: US Vice President George Bush visited Saudi Arabia and met the King.

- **1998**: US Secretary of Energy Bill Richardson visited OPEC countries and openly lobbied the oil ministers.

- On both occasions leaders of OPEC member countries also became involved and met Saudi king. Finally OPEC decided to lower its production.

- **2015 and so far in 2016**: Pressure from within OPEC

  Pressure from outside?

US POLITICIANS ARE NOT YET READY TO ACT
THIS TIME: GREATER FLEXIBILITY OF NON-OPEC PRODUCERS

• Producers outside OPEC have proved more resilient than on the previous occasions of oil price collapse.

• US shale oil – tight oil operations are becoming more efficient:

  - New-well production per rig in 2015 was greater than 2014
  - About 6,500 wells have been drilled but left unfracked. If price improves (say $50-60/bbl), these wells could soon be fracked and brought on stream: 1 mbpd in first year & 0.5 mbpd in second year of production.

  - US shale oil will reclaim its market share – swing producer for the world oil market (a cap for the price of oil)?
GENERAL DISCUSSIONS ABOUT OPEC

• Are oil price cycles inevitable?
• Should oil be left to ‘market forces’?
• Should it be left to the oil majors to stabilise the market as they did in the first half of 20\textsuperscript{th} century and will the companies be able to do so?
• Has OPEC changed? Has its mission changed?
• Is there still a role for OPEC or is it irrelevant?
• Will oil become like other commodities, needing volunteers in the ‘West’ to campaign for ‘fair trade’ oil as they do for coffee, banana, .......defending the farmers in the developing world?
THANK YOU FOR YOUR ATTENTION