International Monetary and Financial Committee

Fourteenth Meeting
September 17, 2006

Statement by Mr. Alipour-Jeddi
on behalf of the OPEC Secretariat

Statement by Mr. Alipour-Jeddi
on behalf of the OPEC Secretariat

International Monetary and Financial Committee
Washington, D.C.

September 2006

OPEC would like assure the delegates attending the IMFC of it's steady commitment to maintaining **oil market stability**. Despite periodic intensification of geopolitical concerns and unexpected production outages around the world, the Organization has proved to be a moderating force on crude oil prices and price volatility. In carrying out its longstanding commitment to market order and stability, OPEC has continued to act on two fronts, increasing supply well above the needs of the market and accelerating capital investment projects to provide additional production capacity.

Since the last meeting of the IMFC, **crude oil prices** have risen steadily to new record highs in July and August before falling sharply to below the level seen at the time of the Spring meeting. A host of factors were behind the upward trend, including the market's increased sensitivity to geopolitical tensions and unexpected supply outages, resulting in a higher "fear premium", as well as continued downstream bottlenecks. In response, crude oil prices reached a **record high** in early August of close to $73/b for the OPEC Reference Basket ($77/b for benchmark WTI). In today's terms, after accounting for inflation and currency fluctuations, this peak was still well below the all-time highs of over $90/b seen in the early 1980s.

However, by the second week of September, the OPEC Reference Basket price had fallen almost eleven dollars to around $60/b ($64/b for WTI). This **considerable decline** was due to a combination of fundamental and non-fundamental factors, namely the easing of political tensions, the lower-than-expected disruption in supplies from Alaska, an uneventful hurricane season, the end of the US driving season and the comfortable level of crude and middle distillate stocks ahead of the winter season.

Despite the above price developments, the **world economy** has been highly resilient, in part reflecting the remarkably favourable global macroeconomic conditions that have prevailed over the last three years. For

2006, world economic growth is estimated to be in line with the healthy rate achieved last year while for next year the world economy is expected to expand at a slower but still substantial pace.

Given the critical role that energy plays in the world economy, OPEC closely monitors the **impact of higher oil prices** on economic growth. The effect of higher oil prices on economic growth and inflation has to date been modest in OECD countries due to the increase in oil efficiency over the last three decades, and better control of inflationary pressures. For a majority of Developing Countries, particularly the large emerging developing nations, strong growth with moderate inflation has been sustained, despite the growing use of oil both in industry and transportation.

So far, higher prices have also not caused a strong retraction of **oil demand** in developing countries but signs of weakness appear in the developed world. Recent data confirm a drop in demand in OECD in the first half of 2006, offset by demand in other areas, mainly stronger than expected demand from China and the Middle East. Due to these recent trends, world oil demand growth in 2006 has been revised downwards from an initial estimate of 1.5 mb/d to 1.2 mb/d or 1.4% compared to the previous year. In 2007, world oil demand is expected to rise by 1.3 mb/d, representing growth of 1.6% over 2006.

The improved price environment over the last two years has been a positive factor for **Non-OPEC supply**. As a result, supply from non-OPEC countries will see a strong rebound over the remainder of this year but particularly in 2007. Next year, Non-OPEC supply is expected to grow by 1.8 mb/d, which is twice the average seen in the 2000-2006 period and the highest level in several decades. Among the factors contributing to this sharp increase in non-OPEC supply are expanding exploration and production activities, particularly in West Africa, Russia and the Caspian region, as well as significant project delays from this year into 2007 and the start-up of large projects in deepwater provinces

At the same time, **OPEC production** has remained near a 25 year high throughout most of 2006. This has helped OECD commercial crude oil stocks to rise above the upper limit of the range seen in the last five years. As a result, commercial crude oil inventories now stand just 110 mb below the all time high reached in the third quarter of 1998. Additionally, OPEC Members have accelerated plans to expand production capacity. As a result of these efforts, OPEC production capacity is expected to increase by 1 mb/d in 2006 to reach 33.3 mb/d by the end of the year. This would boost **OPEC spare capacity** to a comfortable level of more than 10%, compared with 8.0% in 2005 and 6.6% in 2004.

In contrast to the healthy situation on the supply side, developments in the **downstream** have been less satisfactory and **refining bottlenecks** remain. Gasoline prices have risen more sharply than crude prices and have also been accompanied by greater volatility, indicating a tightening in global upgrading refinery capacity. Moreover, the increase in conversion capacity has lagged behind incremental demand for light products. Of the expected 1.3 mb/d increase in oil demand in 2007, the lion's share — some 0.8-0.9 mb/d — is expected to be for light products, while the expansion in already tight refinery conversion capacity may not exceed 0.5 mb/d. In part, this is due to excessive regulation in some consuming countries, which has been a disincentive to invest in this area.

Expected modest demand growth, combined with increased non-OPEC supplies, the continued high OPEC production and ample stock levels, as well as rising OPEC spare capacity should provide **further assurances to the market,** reducing the "fear premium" in the coming months and in 2007. Overall, fundamentals suggest that **prices will be lower on average in 2007** compared to the current year. Whether the market will benefit from the full effect of these trends will depend mainly on downstream developments and non-fundamental factors — particularly geopolitical tensions, a major driver behind the recent surge in crude oil prices.

On the issue of **global imbalances** which has drawn increasing attention, OPEC Member Countries along with the IMF share the view that resolving these imbalances will require time as well as global coordination. In the meantime, OPEC Members are already contributing to the smooth adjustment of global imbalances by recycling their increased revenues. Apart from rising imports of goods and services, a substantial part of the increase in oil revenues is being earmarked for investment in exploration and production to expand capacity upstream and for investment in the refining sector. In the medium term, **OPEC efforts** in both the upstream and downstream should contribute to reducing future imbalances, improving supply security and relaxing upward pressure on crude oil prices.

In this regard, OPEC countries are expediting plans to bring **extra production onstream**, increasing capacity by 4.6 mb/d between now and 2010 with over $100 billion invested in upstream projects. Moreover, planned **downstream refinery projects** in OPEC Members for 2005-2011, which will be adding new capacity of as much as 6 mb/d, are estimated to require capital investments of over $60 billion, although this figure could be substantially higher given recent cost inflation. In order to ensure that the necessary large investments are carried out, clear indications of future demand will be required and every effort should be made to minimise the impact of policy-induced demand uncertainties in consuming countries. OPEC has recently held a successful joint workshop with the International Energy Agency (IEA) on global oil demand outlook, which helped enhance understanding of this key issue.

As part of its efforts to promote mutual understanding and enhance market stability, OPEC attaches great importance to **institutional dialogue and cooperation** with producers, consumers and international organizations, of which the ongoing dialogue with the EU and China are but two prominent examples. In addition, OPEC continues in its commitment to transparency in oil market data through its participation in the Joint Oil Data Initiative (JODI) of the International Energy Forum (IEF). Greater transparency in consumer countries' energy and oil policies would also help reduce uncertainties in supply and demand.

As you are aware, the Organization just held the **Third OPEC International Seminar**, entitled "OPEC in a new energy era: challenges and opportunities", in Vienna on 12–13 September. This biannual event brings together producers, consumers and representatives of major oil companies and international organizations, with the IMF participating for the first time. This follows a recent visit to the OPEC Secretariat by a delegation of the IMF headed by the Managing Director and represents a deepening of cooperation between the two organizations.

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 this regard, the **recent Meeting of the OPEC Conference** agreed that Member Countries would take the necessary steps to ensure that supply and demand remained in balance, with prices at reasonable levels to both producers and consumers, and conducive to continued healthy world economic growth.