Special Quick Report

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The 121st OPEC Meeting and the world oil market

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Introduction

The 121st OPEC Meeting was held in Osaka on September 19, 2002. It is quite exceptional for OPEC to hold a Ministerial meeting somewhere other than Vienna, Austria (where OPEC headquarters are located), or its member country. This year Japan had a chance for the first time (as an Asian oil-consuming nation) to host the meeting in Osaka just before the 8th International Energy Forum (Dialoge between oil-producing nations and consumer nations), scheduled for September 21 to 23. At that time, the world's attention was centered on whether OPEC would increase its production quota (of 21.7 million B/D for its ten member countries, excluding Iraq) while crude oil prices had soared close to $30 per barrel amid grave international concerns over a possible U.S. military attack on Iraq. The following briefly reports on the major decisions made at this past OPEC Meeting, the background and impacts of the decision on the international oil market. This report was written based on information and data collected by the author who was in Osaka to follow up the OPEC meeting.

1. Major Decisions Made at the OPEC Meeting

The three major decisions made at the OPEC Meeting are as follows:

(a) After carefully discussing the future trends of the global economy, expected growth in oil demand, and other factors, OPEC decided to maintain the current production levels (of 21.7 million B/D);

(b) OPEC decided to continue monitoring the international oil market, and commit itself to adopting necessary measures to stabilize the market, including the holding of extraordinary meetings, as deemed necessary;

(c) In consideration of the above, an extraordinary meeting will be held in Vienna on December 12, 2002 to review the international oil market situation. The next regular meeting will also be held in Vienna on March 11, 2003.

2. Background of Decisions

With soaring crude oil prices hovering around $30-per-barrel, there were two major and divergent opinions among the OPEC member countries before the meeting was held. Some member countries (notably Saudi Arabia) maintained that an increase in oil production ceiling should be examined as an option to stabilize the markets, while others (especially Venezuela) were strongly opposed to any proposed increase in production. However, most leading ministers including the Saudi minister, agreed, the evening of September 18, the day before the meeting, to maintain production levels. Consequently, the decision to maintain current production levels was smoothly approved without any heated disputes at the meeting on September 19.

One major reason OPEC arrived at this conclusion is that the ministers all recognized that the current world oil supply and demand is well balanced. Moreover, OPEC believes that the current oil market is not in tight supply based on current oil stock levels and other criteria. All OPEC members agreed on this point, and maintained that the current high-price level is not based on fundamental factors (supply – demand factors), but rather is due largely to a "war premium" that figures in a possible U.S. military attack on Iraq. At the press briefing after the meeting, OPEC Chairman Dr. Lukman suggested that current crude oil price levels included a "war premium" of approximately 3 to 4 U.S. dollars.

Secondly, in addition to the view that the current oil supply and demand is well balanced, the fact that OPEC is extremely cautious about the future growth in oil demand played another important role in their decision. At the beginning of 2002, it was forecasted that the U.S. economy would recover by the 2nd half of the year. However now the outlook appears doubtful. Moreover, the world economy is very likely to linger in the doldrums for some time. Consequently, OPEC is concerned that the growth of worldwide oil demand will be extremely low for this year. In fact, when the author visited the OPEC secretariat this past July to discuss the would oil market situation, OPEC pointed out the sluggish increase in demand for the time being, even in Asia, which is expected to become the center of increase in demand.

OPEC was concerned that a decision to boost production under the present situation of weak oil demand may only create higher risks and place heavy downward pressure on oil prices in the future. In this regard, OPEC may have been affected psychologically by the experience and memory of the crude oil price collapse that occurred on the heels of the 1997 Jakarta Meeting. At that meeting, a decision was made to increase production ceiling just at the time when Asia was mired in an economic crisis.

Thirdly, there was a new development just before the meeting, in connection with a possible U.S. military attack on Iraq--a very important factor behind the current price hike. On September 16, Iraq informed the United Nations that it would unconditionally accept the UN inspection on weapons of mass destruction in Iraq. This announcement caused crude oil prices to post a slight drop (as evidenced by a drop in the WTI futures closing price on Sept. 17 of about 60 cents from the previous day’s level). Of course, there is no way to gauge whether Iraq intends to honor its word by unconditionally accepting UN inspections, and whether the U.S. will approve of such Iraqi action. Yet, it is possible that the argument for increasing production ceiling to stabilize oil prices may have been weakened by this new development.

3. Impacts of the OPEC decisions on the world oil market

When the news broke that OPEC would likely maintain the current production ceiling, the WTI futures price (i.e., near-month futures price, closing price) listed on the NYMEX rose from $29.08 on September 17 to $29.48 the next day (September 18). After the formal decision made by the OPEC meeting was announced on September 19, however, the WTI price stood virtually unchanged at $29.50. This trend suggests that the markets have already factored in speculation of OPEC's decision to maintain its production ceiling.

As far as the market fundamentals are concerned, world oil demand is expected to surpass supply and result in a reduction in oil inventory levels in the 4th quarter of 2002. The author estimates that demand will exceed supply by 0.5 to 0.8 million B/D (which will have to be met by stockpile draw downs) in the 4th quarter of 2002 in the world market. This estimate is based on the following assumptions: Surplus production above OPEC's ceiling of 21.7 million B/D remains at about 2 million B/D (or roughly the same level as now); Iraq's production remains around 1.6 ~1.8 million B/D; and non-OPEC production is stabilized at around 48.3 to 48.5 million B/D.

Meanwhile, the "war premium" that recently bolstered the hike in oil prices is likely to continue in one form or another, although it may be somewhat tempered depending on future developments regarding UN inspections in Iraq. It is still unclear whether the proposed unconditional acceptance of UN inspections will actually be put into force. Moreover, the U.S. has yet to ease its hard-line stance against Iraq.

Taking into account the above perspectives on supply and demand balance and the Iraq issue, it is likely that oil prices will remain at the current high levels for some time and will fluctuate at around $28 to 29 (in terms of the WTI price). At the same time, the markets will probably react sensitively to the actual trends (and the news/report) of the world economy, oil exports, and the oil stocks of consumer countries, in particular in the U.S. and Iraq issue. Under the situation, the oil market is very likely to remain highly volatile.

Under such circumstances, the possibility of a U.S. military attack on Iraq will remain the key factor (or wild card) dictating market behavior. Even if the U.S. attacks Iraq, any price increase could be limited to a short period of time in a situation similar to the “Gulf War” where military action ended relatively quickly, and the lost oil supply from Iraq was compensated for by increased production in other Middle Eastern oil-producing countries, notably Saudi Arabia. In such case, international oil markets would not be too adversely affected. Conversely, if military action required a prolonged timetable or escalation, and the supply of oil from Saudi Arabia and other Middle Eastern oil-producing countries were affected one way or the other, such a situation could be entirely different from the "Gulf War" and would seriously disrupt international oil markets.

While current high oil price levels are likely to remain in the near term, it will likely have an impact on supply and demand. Namely, the current high prices could suppress growth in oil demand and prompt an increase in non-OPEC production. Such a situation would pose more serious difficulties in the future on

OPEC production policy. Putting the Iraq issue aside, if the world economy still continues to linger in the doldrums when the oil demand seasonally drops off in the 2nd quarter of 2003, we will likely face excessive supply in international oil markets, thereby generating strong downward pressure on oil prices. At such time, OPEC will again be faced with a difficult situation.

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