

Reaction slow to OPEC cut

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Energy markets were slow to show confidence that members of the Organization of Petroleum Exporting Countries would follow through on an agreement to reduce production by Nov. 1.

The November contract for benchmark US crudes gained 85¢ to \$58.50/bbl Oct. 19 in New York as Saudi Arabia endorsed a counterseasonal proposal to reduce production by 1 million b/d at the group's meeting in Qatar. But it expired at a 16-month low of \$56.82/bbl Oct. 20 after OPEC voted to cut actual production by 1.2 million b/d to 26.3 million b/d, well below the 28 million b/d ceiling set 2 years ago.

Cold weather and a bigger-than-expected reduction of US petroleum inventories helped boost the new front-month crude contract to \$60.75/bbl on the New York Mercantile Exchange by Oct. 27, however.

Analysts in the Houston office of Raymond James & Associates Inc. said OPEC likely would curtail only 765,000 b/d in its effort to keep oil prices above \$60/bbl on NYMEX. Saudi Arabia immediately agreed to cut 380,000 b/d. Iran subsequently agreed to throttle back by 176,000 b/d, while UAE officials notified customers of a 5% reduction.

"We believe that the Saudis did not like the way this cut was more or less imposed by Nigeria and Venezuela without preliminary discussion with the other members, probably expecting to make good deals by forcing the organization to announce a cut based on official quotas," said analysts at the Societe Generale corporate investment-banking group. "After all, both Nigeria and Venezuela have long been producing less than their official quotas: 120,000 b/d less for Nigeria and 680,000 b/d less for Venezuela. Therefore, if OPEC decided on pro-rata quota cuts totaling 1 million b/d, Nigeria and Venezuela could each have complied with its new official quota by maintaining production and not cutting a single barrel."

With the OPEC basket at \$55.53/bbl on Oct. 27, members still have strong incentive to produce at high levels, said Rick Mueller, senior analyst at Energy Security Analysis Inc., Boston. "Beyond the potential public relations nightmare of cutting output in the face of high prices, there is a strong economic incentive for countries to maximize their revenue while prices remain strong," Mueller said. However, he expects the Saudis "will act quickly to raise production to snuff out any sharp price spike."

At the Centre for Global Energy Studies, London, analysts thought it "questionable whether prices are low enough to persuade OPEC's African members to cut production while demand for their light, sweet crudes remains robust." The OPEC agreement lacks "explicit starting points for individual output cuts" necessary for "real credibility," said CGES analysts. "The quota system—at least in its present form—is dead," they concluded. "Quotas were a useful system to adopt when OPEC was attempting to manage the market during a period of high excess production capacity, but they have little relevance at a time when

most member-countries are producing at or close to capacity.”

Weather moves prices

The new December front-month contract for benchmark US sweet, light crudes lost 52¢ to \$58.81/bbl Oct. 23 on NYMEX but rebounded to \$59.35/bbl Oct. 24 as US forecasts of cold weather triggered speculation of reduced heating oil inventories. It jumped to \$61.40/bbl Oct. 25 when the Energy Information Administration reported US crude inventories plunged by 3.3 million bbl to 332.3 million bbl in the week ended Oct. 20. US oil imports fell 936,000 b/d to 9.5 million b/d with the Louisiana Offshore Oil Port-the largest US oil importing facility-closed for 3 days during that week. US gasoline stocks fell by 2.8 million bbl to 207.4 million bbl, while distillate fuel inventories declined by 1.4 million bbl to 144 million bbl. It was “the biggest weekly decline in petroleum inventories since the week that Hurricane Katrina made landfall [in Louisiana Aug. 29, 2005], flying in the face of expected increases for oil and gasoline,” Raymond James analysts said.

Olivier Jakob, managing director of Petromatrix GMBH, Zug, Switzerland, said crude prices essentially bottomed out in October and would likely climb for the rest of this year. “We expect volatility to remain as we are still in the shoulder period where the winter demand is not fully set in and there is still strong disagreement in the market over the impact of the OPEC oil cuts,” he said.

Benchmark US crudes “will next pass above \$70/bbl long before they pass below \$50/bbl. However, we suspect that it will not be a particularly linear journey, and it may yet take a while,” said Paul Horsnell at Barclays Capital Inc., London.

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