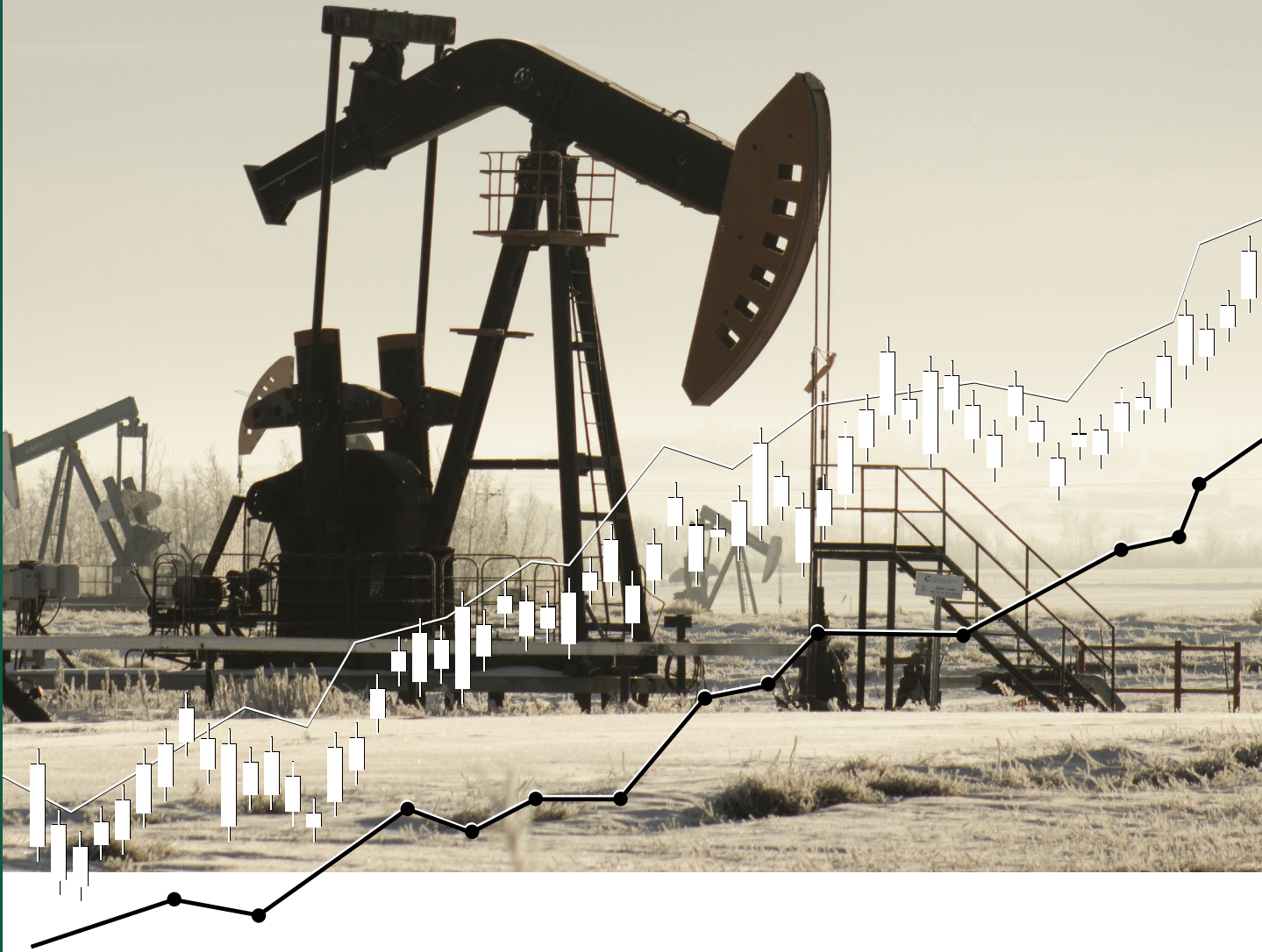




DME

FUTURES INSIGHTS

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OPEC maintains role as swing supplier for oil markets

Producer group's alliance with non-OPEC producers strengthens producer group's hand

Since its foundation in 1960 OPEC, or the Organization of Petroleum Exporting Countries, has been at the centre of oil market policy making, playing a pivotal role in Middle East politics and is a major factor in the global economy.

OPEC's original core members consisted of primarily Middle East production giants (including Saudi Arabia, Iran, Iraq and UAE) but gathered momentum over time with representation from Latin America (including founding member Venezuela), West Africa and Asia.

In more recent times, OPEC's ability to manage market stability has been bolstered by an alliance with non-OPEC producers.

OPEC's key mission statement is to maintain market equilibrium and stability.

Maintaining this equilibrium is a fine balancing act; given oil prices are set at the margin and even a small change in supply/demand fundamentals can have a significant impact on prices.

Under OPEC membership, each producer will commit to a production quota - which collectively allows OPEC to act as the global swing producer, in the way a central bank might manage monetary policy via interest rates.

The 2020-covid pandemic and subsequent record drop in demand during the second quarter led to drastic action with record production cuts from OPEC and fellow producers via the OPEC+ grouping, which aligns OPEC on policy with other major producers, particularly Russia.

Various analysts have written off OPEC over the years, particularly when prices have been relatively high such as the 2010-2014 period when the supply side needed little management.

But bolstered by cooperation from non-OPEC producers, the key OPEC group has reinforced its crucial role in balancing market fundamentals from the demand side.

Although negotiations can often be fraught, even among OPEC members, producers have done enough to bring much-needed market stability with the third-quarter 2020 period one of the least volatile on record.

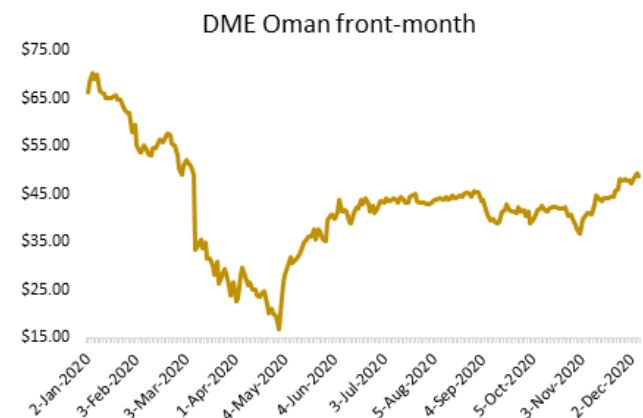
OPEC+ compromise enough to sustain price rally

The OPEC+ producers faced another crunch meeting at the start of December and following two days of tense discussions, the group agreed to start easing the current output cuts from January by 500,000 barrels per day.

This was viewed as enough by the market to underpin the November rally, which saw prices rise by around 30% on the news of several covid-19 vaccine breakthroughs.

The increase means the OPEC+ is set to reduce production by 7.2 million bpd, or 7% of global demand from January, compared with current cuts of 7.7 million bpd.

However, as part of the pact OPEC+ will meet once a month to review conditions, meaning OPEC+ will stay firmly in the spotlight going into 2021.



Secondary sources	2018	2019	1Q20	2Q20	3Q20	Aug 20	Sep 20	Oct 20	Change Oct/Sep
Algeria	1,042	1,022	1,016	878	840	857	855	857	1
Angola	1,505	1,401	1,388	1,267	1,213	1,218	1,236	1,181	-54
Congo	317	324	295	296	287	286	288	271	-17
Equatorial Guinea	125	117	122	110	111	118	103	105	3
Gabon	187	208	195	201	186	184	182	189	7
Iran, I.R.	3,553	2,356	2,059	1,958	1,945	1,942	1,963	1,958	-5
Iraq	4,550	4,678	4,560	4,127	3,696	3,648	3,687	3,835	148
Kuwait	2,745	2,687	2,741	2,464	2,245	2,285	2,292	2,286	-6
Libya	951	1,097	348	84	121	104	155	454	299
Nigeria	1,718	1,786	1,800	1,617	1,463	1,467	1,441	1,488	47
Saudi Arabia	10,311	9,771	9,796	9,212	8,763	8,922	8,956	8,956	0
UAE	2,986	3,094	3,202	2,871	2,596	2,758	2,515	2,441	-74
Venezuela	1,354	796	730	501	362	351	392	367	-25
Total OPEC	31,344	29,337	28,252	25,586	23,829	24,138	24,064	24,386	322

OPEC production falls sharply in 2020

Oil prices and market balancing role

OPEC has often been used as a scapegoat by governments looking to placate motorists during times of high oil prices.

But OPEC is keen to point out that in high retail-price countries the lion's share of the pump price is going into to government coffers.

For example, gasoline at \$50/barrel amounts to little more than 30 cents when converted into liters.

So with motorists in the likes of France, Germany or the UK are accustomed to paying €1.30/litre (\$1.55), after some transportation and retail cost there is still a huge markup in the form of taxation.

In fact, drivers in Western Europe will pay more than double what their U.S. counterparts pay at the pumps, with U.S gasoline taxation a fraction of that in Europe.

The producer group is sometimes labelled a cartel, although at current production levels OPEC is actually around 25% of global output, and even prior to covid-19 was around a third of oil output.

So clearly OPEC cannot 'set' oil prices, but can set policy to help match supply with demand.

While consumers will naturally favor low prices, in the longer term this will lead to sharp reductions in E&P (exploration and production), which in turn will cause a steep fall in production and higher prices in the long run.

OPEC ramped up production during 2005-2008 bull run and for a period during the mid-2010s when prices were above \$100/b, did away with quotas altogether.

There are also broader 'hidden benefits' for the markets and global economy.

OPEC as a group, has always tried to keep several million bpd of spare capacity, acting as buffer against sudden supply losses – Libya being the most recent example.

This spare capacity has in recent years primarily come from Saudi Arabia's export capacity, with support from fellow Middle East producers Kuwait and UAE.

This is all costly as the additional capacity needs to be funded in order to keep the oil fields ready to ramp up, plus pipelines and storage facilities need to be maintained.

This does not come from a central fund but the costs are swallowed by the host nation.

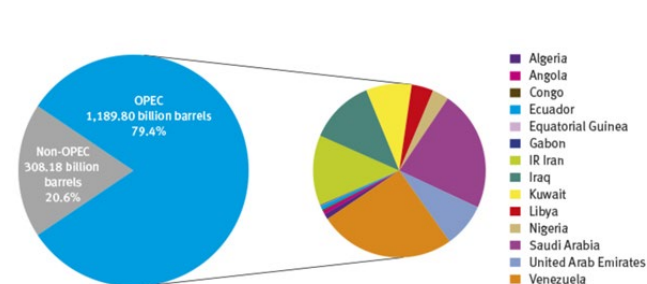
OPEC reserves

While the OPEC group may be under a third of current

global production, the group collectively sits on almost 80% of the world's known crude oil reserves.

Venezuela has the largest reserves at over 300 billion barrels (global demand is around 35 billion bpd) although much of this is very heavy crude which is unlikely to be produced.

Saudi Arabia is next with 267 billion barrels and Canada 167 billion barrels, followed by Iran, Iraq and UAE – illustrating why the Middle East will maintain its position as the world's primary supplier of oil.



OPEC proven crude oil reserves, at end 2018 (billion barrels, OPEC share)

Venezuela	302.81	25.5%	Kuwait	101.50	8.5%	Algeria	12.20	1.0%	Gabon	2.00	0.2%
Saudi Arabia	267.03	22.4%	UAE	97.80	8.2%	Ecuador	8.27	0.7%	Equatorial Guinea	1.10	0.1%
IR Iran	155.60	13.1%	Libya	48.36	4.1%	Angola	8.16	0.7%			
Iraq	145.02	12.2%	Nigeria	36.97	3.1%	Congo	2.98	0.3%			

OPEC traces its roots back to the 'Baghdad Conference' which was attended by founding members Iran, Iraq, Kuwait, Saudi Arabia and Venezuela.

During the last 60 years OPEC has seen many ups and downs, plus members come and go, yet, has been a constant and mostly calming presence throughout the decades.

The 2020 global pandemic has strengthened the OPEC+ alliance and with monthly meetings set to be a feature well into 2021, OPEC's position and responsibilities can only be enhanced.

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