

FINANCIAL MARKETS

THE ORIGINS
(AND FUTURE)
OF OPEC



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LET'S TALK ABOUT OIL

FOREWORD

Are you a trader that's interested in oil? If you are, you'll know that we are in interesting times. In recent weeks (as of December 2018), we've seen the price of oil plummet to 2018 lows (below \$60 a barrel).

To understand why oil prices have fallen - and where they could go in the future - it's important to be familiar with the role of OPEC.

That's the purpose of this eBook - to explore OPEC's historical influence, and how it could change in the future.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

THE HISTORY OF OPEC

WHAT IS OPEC?

At the Baghdad Conference, between 10th and 14th September 1960, the Organisation of the Petroleum Exporting Countries (OPEC) was formed.

OPEC was established to ensure that oil producing countries worked together to formulate fair petroleum policies. Specifically, the organisation was created to ensure that oil prices were kept at a fair and stable rate for all producers and investors.

Today, OPEC still performs the same function.

OPEC started with just five members - Iran, Iraq, Kuwait, Saudi Arabia and Venezuela. Since 1960, 10 more countries have joined the five founding members.

The first country to join the five founding members was Qatar in 1961. Indonesia and Libya also joined one year later in 1962. Five

years later, the United Arab Emirates followed suit. Two years after that, in 1969, Algeria also joined.

In the 1970s, three new members decided to join - Nigeria in 1971, Ecuador in 1973 and Gabon 1975.

No new members joined OPEC until Angola in 2007. A decade later in 2017, Equatorial Guinea decided to join, closely followed by the Republic of the Congo in 2018.

MEMBERSHIP SUSPENSIONS

Throughout OPEC's history, there have been instances where countries have suspended their membership. Most of these suspensions have been caused by production volume quotas. Remember - OPEC member states need to pay annual membership fees and obey OPEC's rules and regulations.

For instance, Ecuador suspended its membership in 1992 because it wanted to produce more oil than OPEC permitted. In addition, Ecuador didn't want to pay the annual \$2 million membership fee. However, it joined OPEC again in 2007. Similarly, quotas and fees led to Gabon suspending its membership in 1995, before rejoining in 2016.

The only lapsed member of OPEC is Indonesia. It suspended its membership in 2009 as it had become a net importer of oil. Indonesia joined OPEC again in 2016 but suspended its membership later that same year as OPEC introduced a 5% cut in oil production for its members.

DECISION MAKING

OPEC requires unanimous agreement from all of its members to make changes to oil production output. Remember - in 2016, OPEC accounted for 44% of the world's total oil production. This means that OPEC's oil production decisions have a major impact on global supplies of oil.

INFLUENTIAL MEMBERS

However, not all OPEC members carry the same weight within the organisation. In other words, the countries that produce the most oil yield the most influence.

At this moment in time, Saudi Arabia produces the most oil by a considerable distance (it produced 10,460,710 bbl/day in 2016). For context, Iraq was the second-highest oil-producing OPEC member in 2016 (it produced 4,451,516 bbl/day).

Due to the volume of oil it produces, many view Saudi Arabia as OPEC's leading member, and as such, it yields considerable influence.

ARE THE TIMES CHANGING?

QATAR'S FUTURE

Change is on the horizon for OPEC. On Monday 3rd December, Qatar - which was the first country to join the five founders - announced it would leave the organisation in January 2019.

In a statement, Saad Sherida al-Kaabi, Qatar's energy minister, explained: "The withdrawal decision reflects Qatar's desire to focus its efforts on plans to develop and increase its natural gas production from 77 million tonnes per year to 110 million tonnes in the coming years."

Despite al-Kaabi claiming that Qatar's decision to leave OPEC was purely economical, many commentators have pointed to geopolitical tensions in the Middle East. Specifically, Saudi Arabia and other Middle East states have put a land, maritime and air blockade on Qatar - accusing Qatar of supporting terrorism (something it denies).

Qatar also believes that OPEC is essentially run by one member state: Saudi Arabia.

SAUDI ARABIA, US & RUSSIA

Saudi Arabia's influence over OPEC has been highlighted in its recent interactions with the US and Russia. Together, these three countries account for over a third of the world's oil production

Less influential OPEC members have reportedly been unhappy with Saudi Arabia responding to US requests to increase oil production to lower oil prices. Saudi Arabia has also been coordinating closely (outside of OPEC) with Russia in relation to oil production levels.

Commentators suspect this dynamic could cause further rifts between OPEC members.

Qatar's departure from OPEC is very unlikely to change the organisation's oil production decisions (Qatar accounts for less than 2% of oil production from OPEC members). However, it does pose longer-term questions about the influence of smaller OPEC members.

OPEC DECEMBER MEETING

In the short and medium term, investors and traders are processing news from OPEC's December meeting.

The organisation confirmed an oil production cut of 1.2 million barrels per day across OPEC members (excluding Iran) and

allied oil-producing countries to support the oil market. The announcement boosted WTI Crude by 3.73% to \$53.41. Brent Crude also rallied by 4.15% to \$62.55.

However, the US administration is likely to continue to push Saudi Arabia to maintain or increase production levels to keep oil prices low. This is a situation traders should closely monitor.

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