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Oil at \$50 Looms as OPEC Plans Cut, Keeps to Quota (Update2)

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By Grant Smith



March 9 (Bloomberg) -- OPEC's record production cuts are draining the glut in world oil markets, leading traders to bet that \$50 crude is two months away.

Ever since oil began its 69 percent plunge from a record \$147.27

a barrel in July, traders have been looking for a bottom. Now that the Organization of Petroleum Exporting Countries reduced supplies 13 percent since September, inventories are falling 1.4 million barrels a day, according to PVM Oil Associates Ltd., the world's biggest broker of energy trades between banks. OPEC will limit exports again when the group meets March 15, according to a survey by Bloomberg News.

OPEC states have more of an incentive than ever to restrict output because the combination of declining prices and the global recession will reduce earnings 59 percent this year to \$402 billion, according to the U.S. Energy Department. Crude demand will drop for a second year, the first back-to-back decline since 1983, the **International Energy Agency** said.

OPEC's cutbacks are "enough to address the surplus," said **Harry Tchilinguirian**, the senior oil analyst at BNP Paribas SA in London. "If they do more and try to pursue a price target too aggressively, there's a risk of over-tightening the market when the economy is weakening, stalling the recovery."

Expectations for a rally gained as oil for April delivery rose for a second day, advancing as much 7.3 percent to \$48.83 a barrel on the New York Mercantile Exchange. The contract, which rose 1.7 percent last week after jumping 12 percent the previous week, traded at \$47.61 at 11:18 a.m. local time.

Futures will rebound to average \$49.56 a barrel in the second quarter, according to the mean of 25 analyst forecasts compiled by Bloomberg since December.

Options Double

The number of contracts that give traders the option to buy crude at \$50 before May 14 more than doubled last week, to 16,952 on the Nymex. The price of the contracts rose 8 percent.

Oil may reach \$60 a barrel should OPEC cut production, said **Pierre Andurand**, chief investment officer at **BlueGold Capital Management LLP**, the London hedge fund that returned 31 percent this year. **Boone Pickens**, the billionaire hedge fund manager, said he expects \$75 in 2009, in a CNBC interview last week.

OPEC ministers from Venezuela, Algeria and Qatar said stricter limits may be needed at the March 15

summit in Vienna. While Saudi Arabia, the world's largest exporter, has yet to express a view, **King Abdullah** and Oil Minister **Ali al-Naimi** said last year that \$75 is a fair price for producers and consumers.

'Cut Likely'

"A cut by production countries is more likely," Algerian Oil Minister **Chakib Khelil** said in a March 2 interview in Madrid. "It's very much tied to the economic crisis, which is much deeper than everybody thought."

Angolan Oil Minister **Jose Maria Botelho de Vasconcelos**, OPEC's president, said in an interview with **Spiegel Online** published today that the organization will cut if necessary at the March gathering.

In the Bloomberg survey, 31 of 41 analysts said OPEC will limit output for the fourth time next week. Of those, 13 expect a reduction of 500,000 to 1 million barrels a day, 12 say 1 million barrels and two estimated 1.5 million. The rest declined to provide an estimate. Ten of the 41 analysts anticipated no change in the quota. Bloomberg surveyed the analysts March 3 and March 4.

The 12 OPEC nations provide 27.775 million barrels a day, or about 33 percent of global consumption. The members -- Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, Venezuela and the United Arab Emirates -- control 76 percent of the world's reserves.

U.S. Stockpiles

U.S. crude **stockpiles** have leveled off after increasing 17 percent between October and January. Supplies dropped in the last week of February, only the fourth decline since September.

The drop in global inventories is shrinking profit earned from storing crude, paid from a so-called contango, where prices for delivery in the future are higher than costs for immediate consumption. The potential \$17.93-a-barrel profit available in December to speculators who bought and stored oil for a year has plunged 57 percent for London's Brent oil.

Dubai crude, a benchmark for OPEC oil exports to Asia, now costs more for immediate delivery than in the months ahead. The so-called backwardation is a sign of tightening crude supplies. In the last two weeks, BP Plc, the world's third-largest oil company, sold and unloaded more than 2 million barrels stored on the supertanker Eagle Vienna it had moored off Scotland's Orkney Islands.

'Contango Disappearing'

"The market is going to have strong upside, 10 or even 15 percent, even if OPEC doesn't cut," said **Johannes Benigni**, chief executive officer of Vienna-based consultant JBC Energy. "The contango is slowly, but surely, disappearing and that shows the earlier cuts are working."

Still, the deepening global economic slump may erode oil demand faster than OPEC can cut as chemical plants shut, cargo ships sit idle and motorists stay at home. U.S. unemployment rose to 8.1 percent in February, the highest in 31 years, indicating the recession is worsening.

The **IEA** in Paris forecasts a 1 million-barrel-a-day drop in consumption this year because of the recession. In the second quarter, demand will contract by 600,000 barrels a day to 84.2 million a day, as refiners perform seasonal maintenance work, the agency said.

Inflation Threat

In the U.S., higher energy costs threaten to spur inflation as the government spends \$9.7 trillion to end the worst economic crisis since the 1930s. Every \$10 rise in oil increases the share of global GDP spent on crude by about 0.5 percentage point, according to Longview Economics in London.

"OPEC might be in control of oil prices to some extent now," BlueGold's Andurand said in an interview. "OPEC should be cautious on the production side as the economy is getting worse."

Oil prices surged fivefold in five years before peaking at \$147.27 in July. In the same period, OPEC output rose 23 percent to a record 32.775 million barrels a day. As the sub-prime crisis spread, freezing

credit, prices collapsed 78 percent to a low of \$32.40 in December. OPEC responded with three production cuts.

Oran Meeting

At the group's Dec. 17 meeting in Oran, Algeria, the group reduced quotas by 2.2 million barrels a day, extending curbs enacted in September and October. Members completed about 87 percent of their cuts last month, data compiled by Bloomberg show. Crude prices have climbed 40 percent from December's low.

A rally would help **BP**, **Exxon Mobil Corp.** and the rest of the industry, which needs to invest \$350 billion a year on the next generation of oil and gas fields, according to the IEA.

Higher prices would also ease budget strains from Russia to the United Arab Emirates. Venezuela will have to devalue its currency because of lower oil revenue, according to Goldman Sachs Group Inc. Iran's budget deficit may balloon to \$46 billion, a parliamentary report said in February.

"Forty dollars a barrel has some difficulty, even for Saudi Arabia and Kuwait," said **David Kirsch**, an analyst with Washington-based PFC Energy, a consulting company. "Some countries can survive at that level, but all of them are uncomfortable."

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