



The prospects for oil prices in 2012: Political volatility and economic uncertainty

Professor Paul Stevens

Senior Research Fellow (Energy) Chatham House

Professor Emeritus, University of Dundee

Visiting Professor University College London (Australia)

BIEE-Cass Business School Joint Event

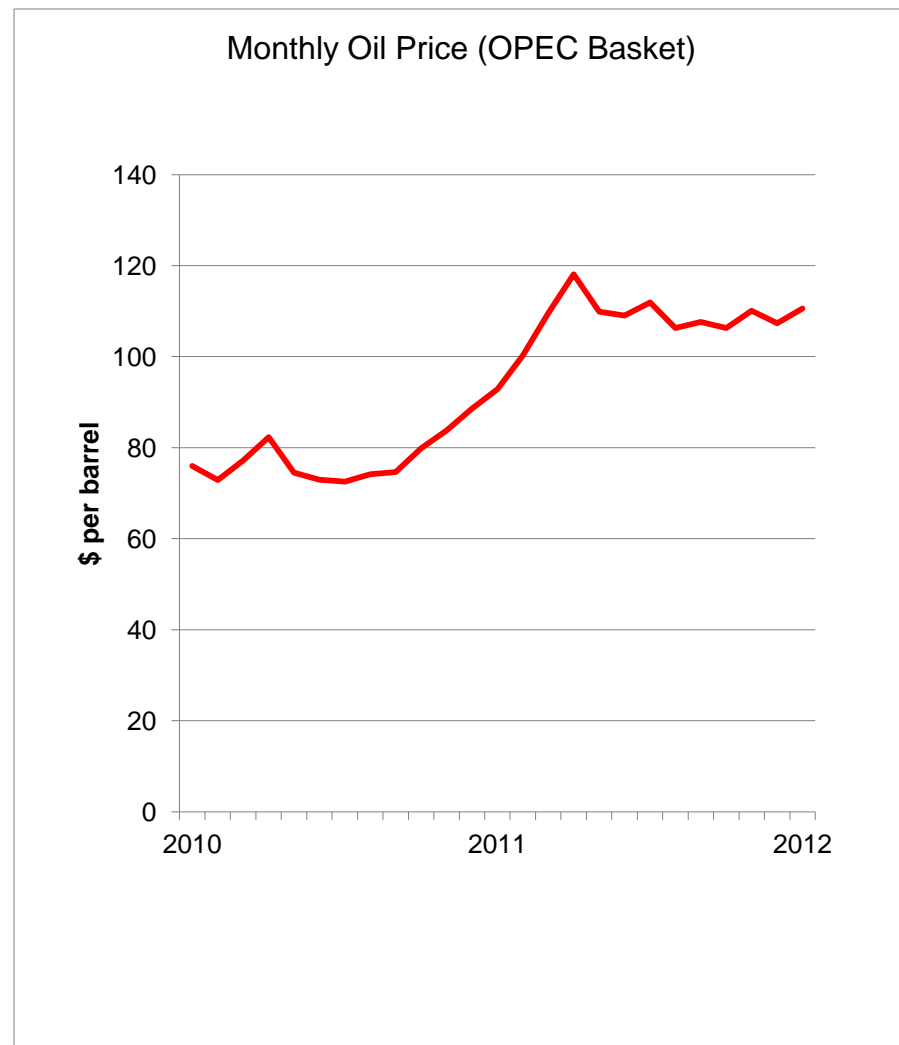
London 11th January 2012

Outline

- A framework for analysis
- What happened in 2011?
- What are the issues for 2012?
 - Economic recession
 - Geo-politics
 - Iran
 - Iraq
 - The Arab Uprisings
 - Nigeria
 - And

Framework for analysis

- Recent price history
- The two markets for oil



Framework for analysis

Wet barrel market

- *Trading real barrels
- *Spot and term contracts

Paper barrel markets

- *Commercial versus non-commercials
- *Money managers versus speculators



Linkages?



Framework for analysis

Wet barrel market

Paper barrel markets

Influences perceptions about surplus/shortage

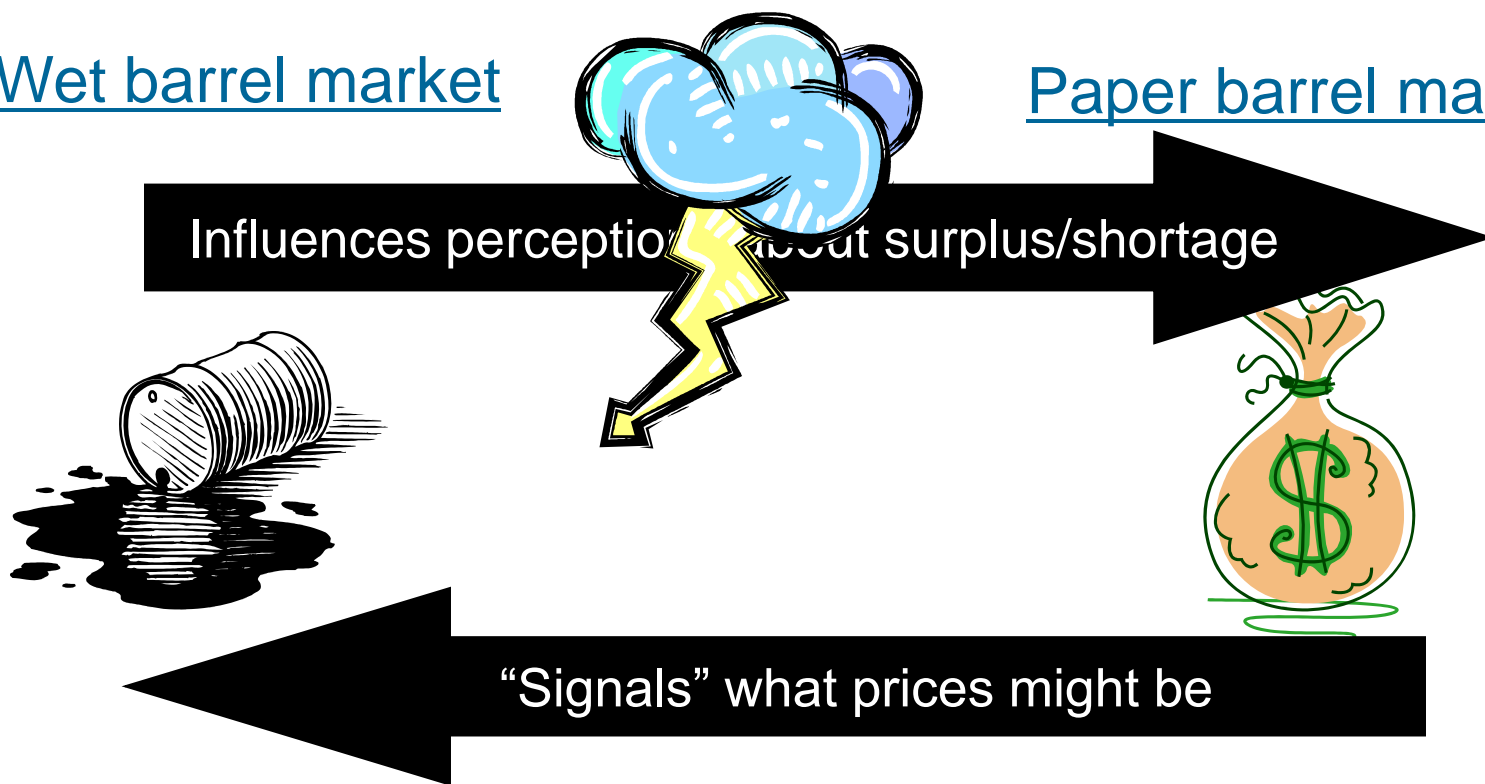


“Signals” what prices might be

Framework for analysis

Wet barrel market

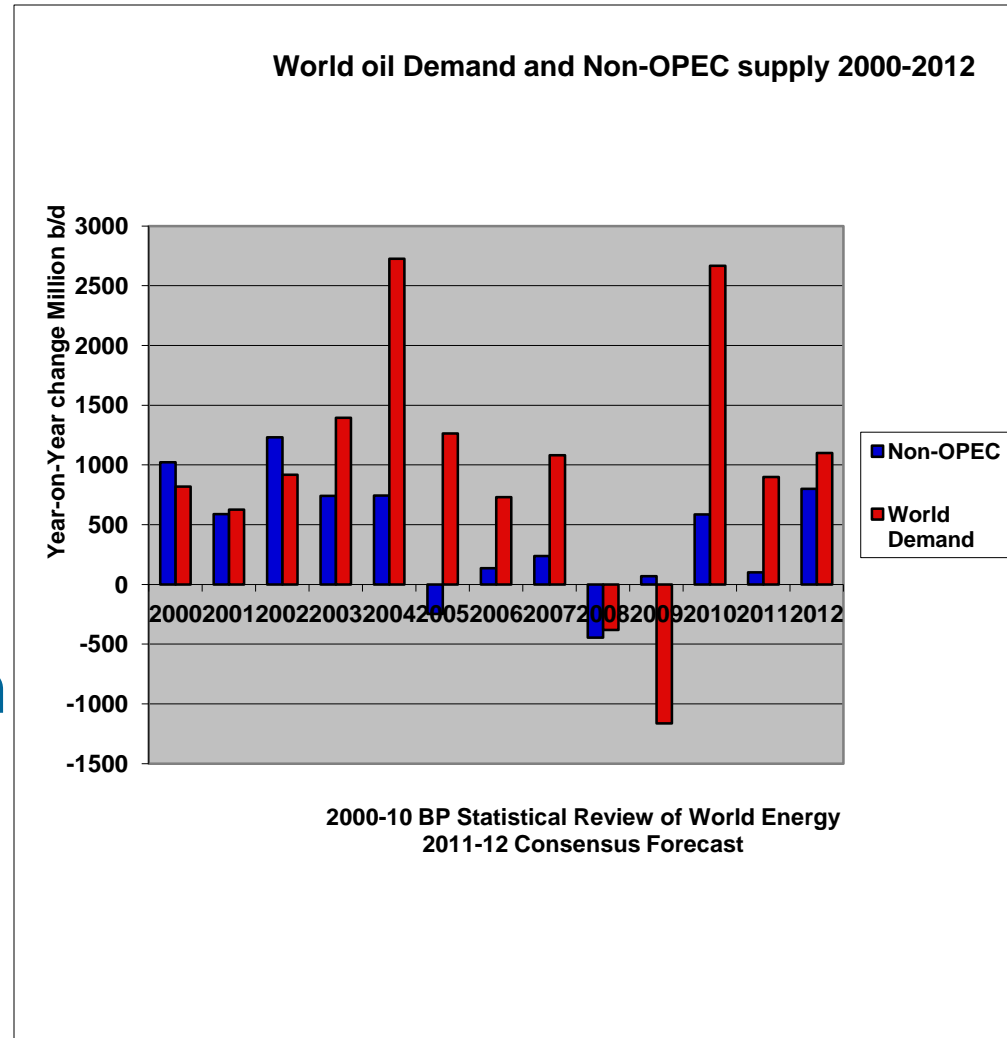
Paper barrel markets



Frequently there is a disconnect between the two markets because the money managers “misread” the wet barrel market – This is not new: see foreign exchange markets and “scapegoat theory”

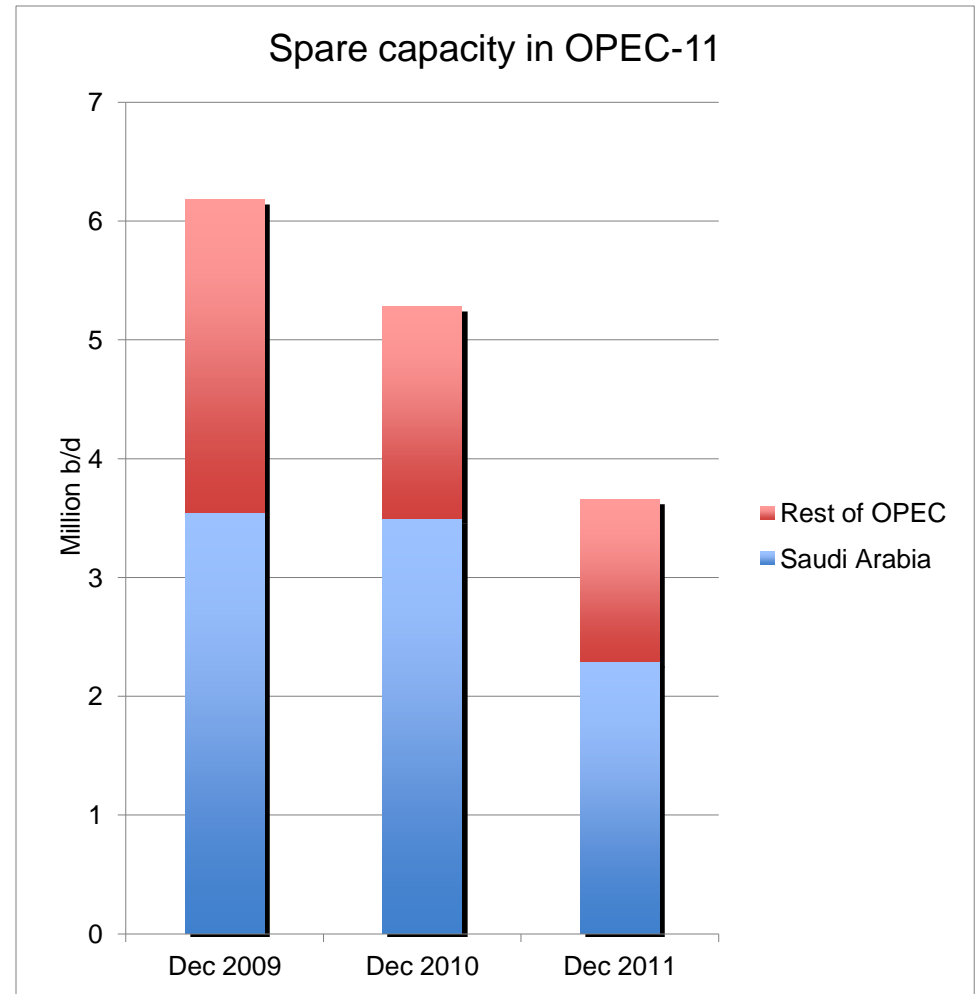
What happened in 2011 in the wet barrel market?

- Relatively strong demand
- Very poor Non-OPEC performance
- Arab uprisings = Libyan supply disruption
- Result



What happened in 2011 in the wet barrel market?

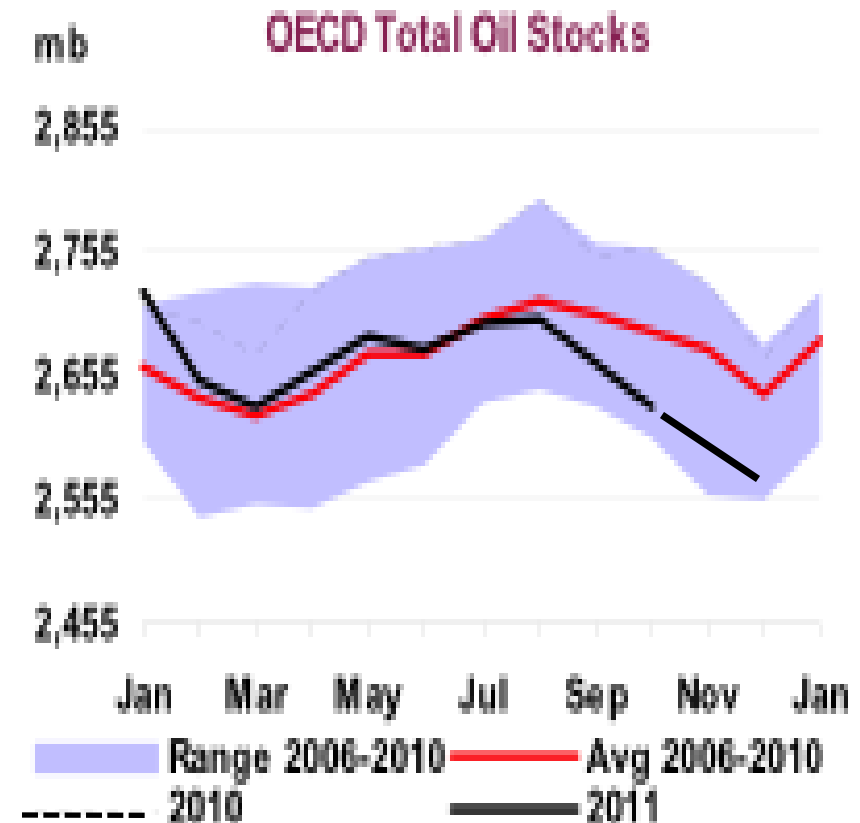
- Decline in OPEC spare capacity
- Remaining capacity is heavy and sour



IEA Oil Market Report Various issues

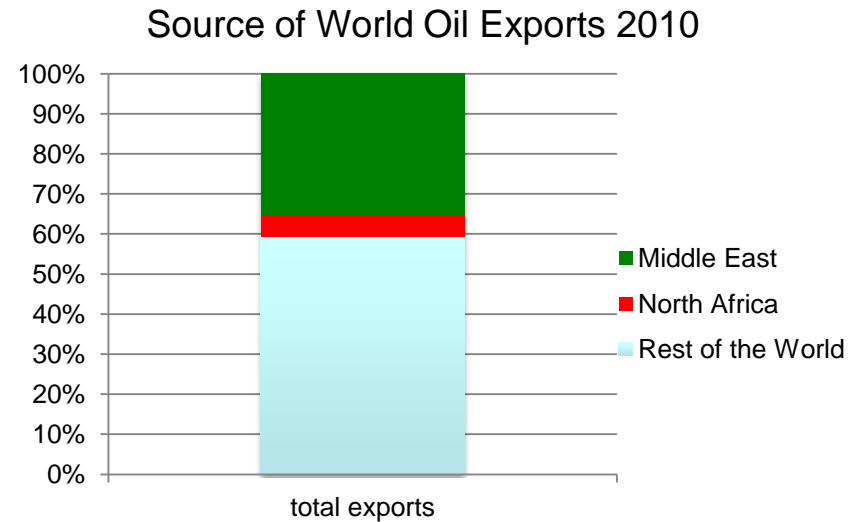
What happened in 2011 in the wet barrels market?

- Stock overhang of the last few years erodes – beware the 31st December and US tax games
- **At the end of 2011 the market was very tight!!!!**
- But what of the Paper Markets given the Arab Uprisings?



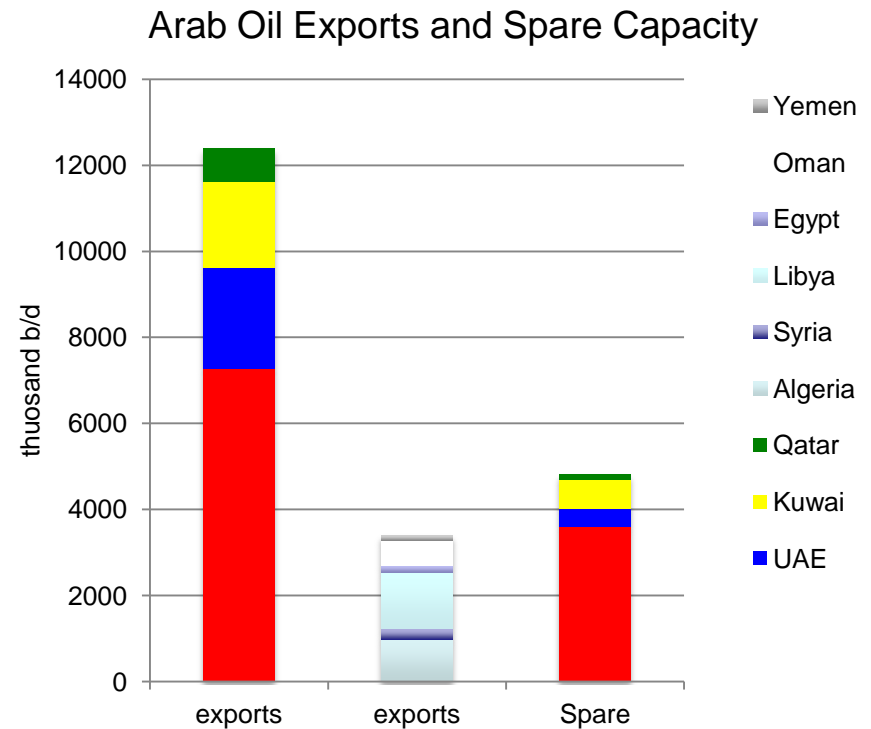
What happened in 2011 in the paper markets?

- Arab uprisings scare the markets because of a fear of contagion



What happened in 2011 in the paper markets?

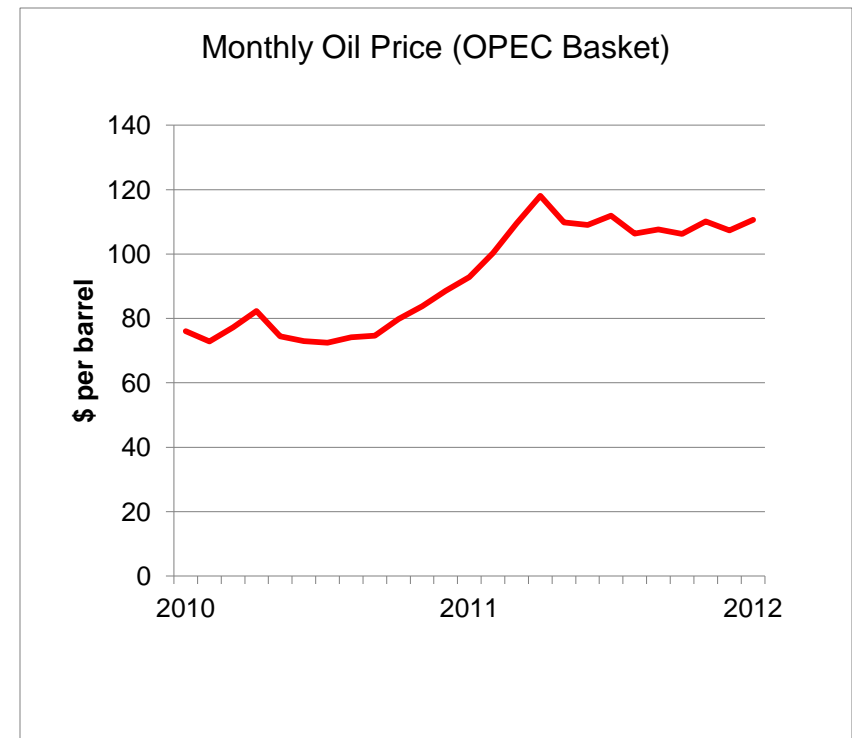
- Arab uprisings scare the markets because of a fear of contagion
- However, the reality is less threatening



Note: Excludes Iraq. Total World Oil Exports = 52,333 thousand b/d Arab World = 30%

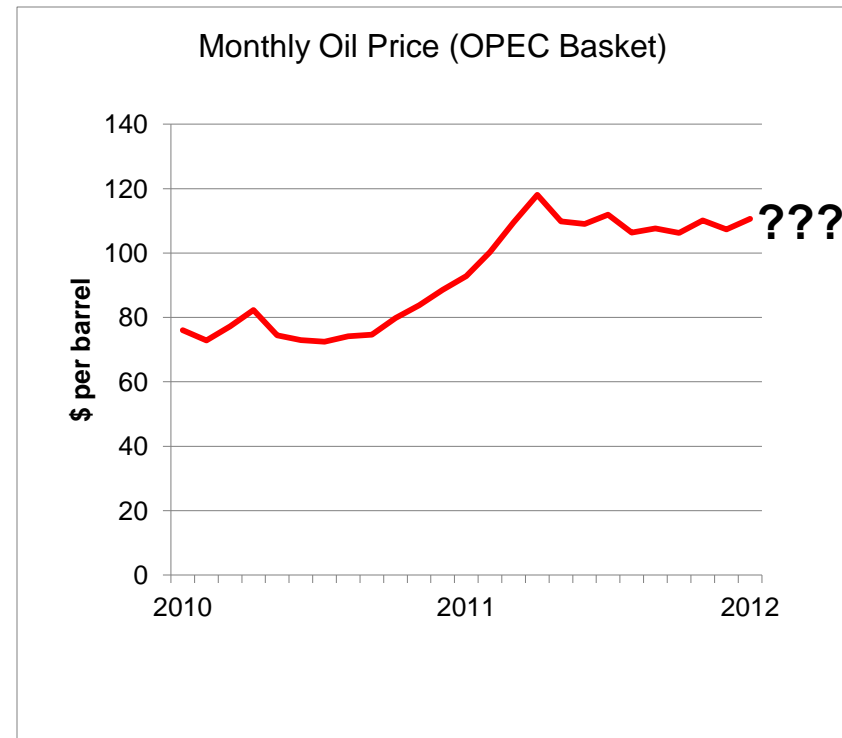
What happened in 2011 in the paper markets?

- Arab uprisings scare the markets because of a fear of contagion
- However, the reality is less threatening
- The wet barrel market (eventually) manages the loss of Libya rather well
- Then global recession looms...



Outline

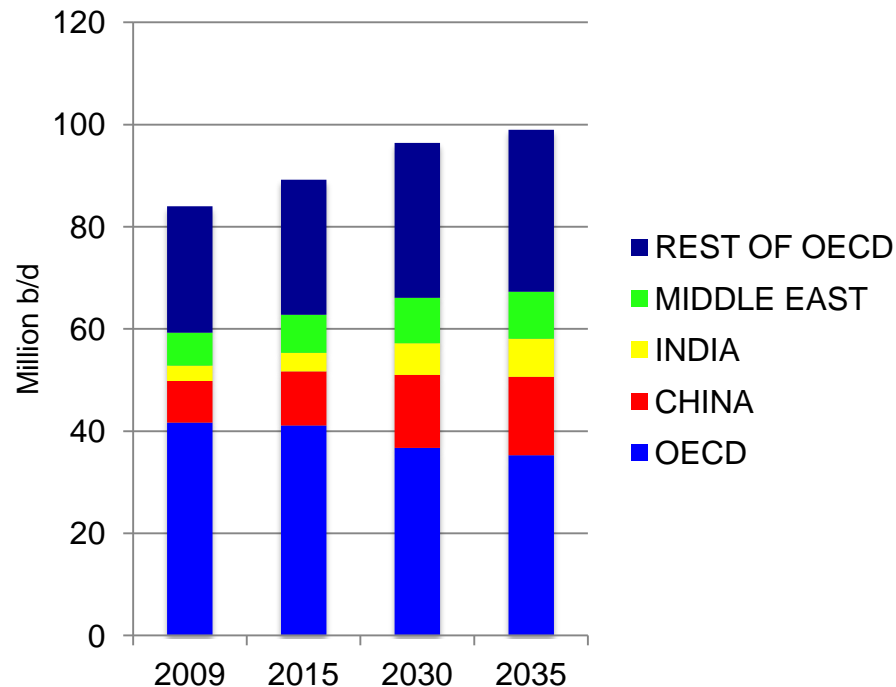
- A framework for analysis
- What happened in 2011?
- What are the issues for 2012?
 - Economic recession
 - Geo-politics
 - Iran
 - Iraq
 - The Arab Uprisings
 - Nigeria
 - And



What are the issues for 2012? Economic recession

- Recession and oil demand
 - Euro zone crisis – remember 2008. July 3rd WTI = \$147 per barrel. End of 2008 \$33 per barrel
 - The MICs and price subsidies

Oil demand by region IEA New Policies Scenario 2010



The key point: The MICs account for the bulk of the growth = 68% in Non-OECD growth 2009-35

What are the issues for 2012? Geo-politics: Iran

- EU Oil Embargo likely to be finalized 30th January – “transitional friction of prices” but “one big pool” ... However ...
- Iran’s likely responses?
 - Interfere with Hormuz? Unlikely!
 - Would lead to a shooting war
 - Double edged sword
 - Once used, loses a major deterrent
 - Interfere in Iraq and Afghanistan?
 - Pressure GCC not to supply?
 - Retaliate against EU interests?

BUT if a military attack on Iran ...



The Straits of Hormuz carried around 17 million b/d = 32 % of global oil exports in 2010 and 28% of global LNG exports 15

What are the issues for 2012?

- Geo-politics: Iraq
 - US troops withdrawn
 - Shi'a élites in Baghdad trying to weaken Sunni opposition
 - The IOCs are getting seriously disillusioned with Baghdad
- Geo-politics: The Arab Uprisings
 - Libya back to 840,000 b/d in December but uphill from now
 - Syria is still to play out as is Yemen
- Geo-politics: Nigeria
 - November production 2.1 million b/d
 - Strikes over domestic oil pricing and subsidy removal
 - Boko Haram causing disruptions

Do we have any conclusions for 2012?

- Huge geo-political uncertainties looming
- Huge economic uncertainties looming
- Each will play off the other...
- Oil price and oil markets are in for a very rough roller coaster ride



CHATHAM HOUSE

www.chathamhouse.org.uk

THANK YOU FOR YOUR ATTENTION

<https://www.chathamhouse.org.uk>