The 171st. Meeting of the OPEC Conference

Vienna, Austria, 30th. November, 2016

OPEC GETS THE DEAL – MARKET TO CUT BY 1.8mbpd!

In reality, it could have gone either way. So easy for market followers to dismiss any incentive that OPEC may try to implement but the true resolve was there and members fell into place and with that, Russia came too.

The success overtook the mistrust between leading members and non-OPEC producers with the realisation that the cartel and its competitors may never again have such an opportunity to unite for a common course and share out the spoils of the market. How long it will last for is another matter and only time will give the answer.

Each member country has accepted an output ceiling with Saudi taking the largest cut followed by Iraq and Iran. Libya and Nigeria have been exempted and Indonesia which had just re-joined OPEC has once again left the cartel. The total cut for OPEC will be 1.2mbpd based primarily on October figures but not effective until January and this will be the first cut since 2008 but the next surprise came with the announcement that Russia would actually cut by 300,000 leaving other non-OPEC producers to be responsible for the remaining 300,000. Supposedly OPEC members have signed up to the deal but it seems to be contingent on Russia and other non-OPEC producers formally signing too, to make the deal effective.

For this to happen another Meeting has been scheduled to take place on 9th. December in Moscow. The way I understand it is that Russia agreed to come in if all of OPEC did, but OPEC has indicated that it would only cut if non-OPEC did. Should they not reach agreement in December, my understanding is that the deal will be unworkable, OPEC will not go it alone.

To ensure compliance and to monitor the benefit of this deal a committee has been set up under the Chair of Kuwait supported by Algeria and Venezuela. It will have the support of the Secretariat and will report back to OPEC in time for the next scheduled Meeting in May. Again I can only assume that the arrangement will be reviewed at the meeting and they will then decide whether to proceed further or revert back to the October levels in full. Meanwhile oil prices have already moved by around $4 since the announcement.

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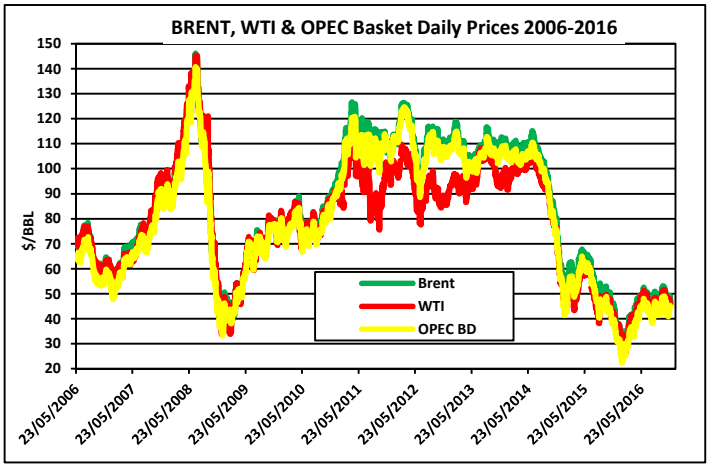
This was the day OPEC managed to pull its members together and also to include Russia, it's main competitor. Naturally, the USA was not present or part of the deal. The opening address outlined the progress since the Algiers meeting at the end of September. There was a recognition that the market was re-balancing but there was concern at the price volatility.

This year they still expect non-OPEC supply to contact by 800,000, more or less in line with the EIA and IEA views. Next year they see little growth in non-OPEC supply, perhaps around 200,000 barrels per day but the real benefit will come from increased demand of 1.2mbpd supported by global economic growth forecasts remaining reasonable for both 2016 and 2017, at 2.9 per cent and 3.1 per cent respectively.

They are concerned that OECD commercial oil stocks are still more than 300 million barrels above the five-year average and they want to see this level fall back within the range. Furthermore, there is also concern that OECD inventories are also above average and they feel that as stock levels fall, prices rise. Investment in the industry is key and by 2040 they estimate that global oil demand will increase by 16mbpd to 109mbpd and for this the level of spending required with be $10 trillion for both upstream and downstream.

Such action has been taken as global spending on exploration and production investments fell in both 2015 and 2016, and some are now even talking about this continuing. A third year of investment falls would be unprecedented for the industry and the effect of OPEC's decision today will alleviate the impact of this for tomorrow.



Throughout the process over the last six months or so, in the background, greed, mistrust and hatred has prevailed, making it is very difficult to see how such a group could ever sit down around a table and agree a mutually acceptable strategy but it seems OPEC has come together.

In addition, one has to bear in mind internal and external issues that prevail but the resolve to take the initiative has, perhaps for now, relieved the market of further exposure than ever before to the impact of further long term low oil pricing and reducing investment opportunities. Perhaps the realisation of failure galvanised the main players to think again. The adjoining chart illustrates how prices have moved and how during the recent negotiations have remained within a tight range of $40-50, lacking any serious direction as the OPEC dialogue was supposedly floundering.

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One has to look at the profile of the OPEC Membership. Saudi Arabia and the Gulf Co-operation States – Kuwait, UAE & Qatar – make up around 50% of the OPEC output, while Iran and Iraq together make up around another 25%, so between them they control 75%. This means that the remaining eight members have virtually no clout in terms of decision making. Saudi has been the leader for many years and able to decide for others on strategy and whenever a cut has been decided on, Saudi has taken the biggest hit but no more. Conversely, Iran and Iraq have always had to follow the Saudi lead but are now strong enough individually and collectively at twenty-five percent of the output, to argue, state their own terms and hold Saudi to ransom. Without the agreement, Saudi could have had to walk away.

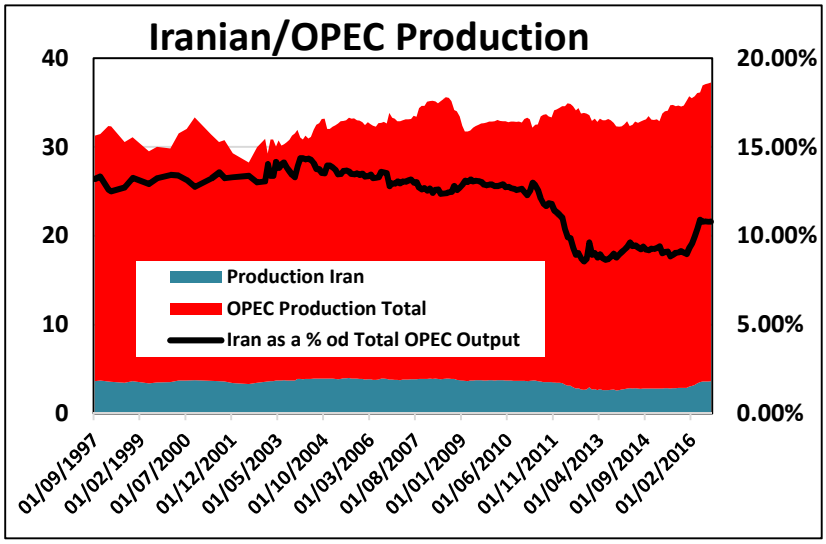
The running for the cut this time has again come from Algeria, supported by Venezuela and together they cover about 10% of OPEC output. They could not sway the leaders themselves but once again by acting as the mediators, putting forward the plan and mediating between the members, have played an important role in achieving this historic deal. As a country, Algeria has much gas and can also benefit dramatically from solar power to feed the energy needs of its growing yet impoverished population while Venezuela has substantial reserves.

Venezuela has been hit hard by lower oil prices and, like many other OPEC members, assumed that the oil price would stay at $100+ and has spent revenues accordingly without bothering to re-invest in the infrastructure. Furthermore, by nationalising and removing foreign investors without facilitating its own domestic capabilities, the country has left itself with a failing infrastructure and limited expertise. In the last two years, the situation has since been exacerbated by falling oil prices.

Nicholas Maduro the current president does not have the true mandate of the people yet continues to cling to power by persecuting and imprisoning opposition leaders. He has few friends around the world and particularly those willing to offer financial support. Meanwhile, law and order is failing and queues lead to whatever food shops there are and buyers are only allowed to buy on a specific day each week with choice is restricted to whatever is available.

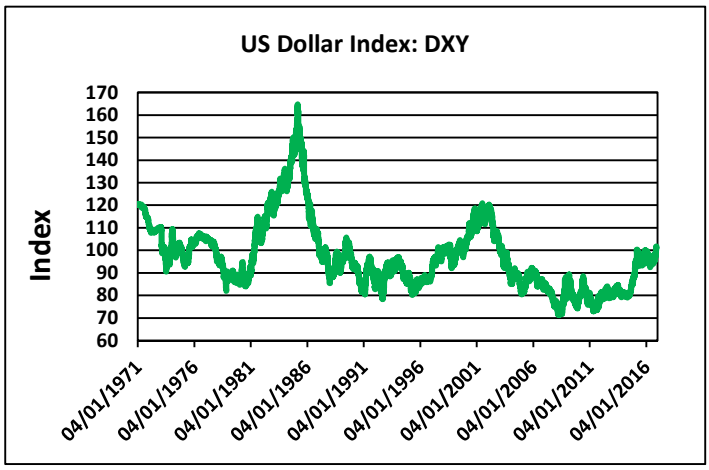
The geo-political situation and tension runs across the group. At the very top there is acrimony between Saudi and Iran. The Arab world is fearful of Iran and its supposed plans for nuclear development and with Saudi supporting the government of Yemen while Iran is supporting the Houtis who are trying to overthrow it, tension is high. Saudi has traditionally had the backing of Western nations but this is now waning following the indiscriminate bombing of the Houtis, supported by Iran, on Yemen. Saudi has attempted to restrict movements of Iranian vessels through its waters and also exerted pressure elsewhere to ensure that transportation of Iranian oil is held back and with Iran seeking exemption from any restriction on output until it has regained its original position within OPEC, Saudi will struggle to implement any deal to curtail output.

The adjoining Chart illustrates how the relativity between total Iranian output and total OPEC output has not been maintained. This is the reason why Iran believes that it has the right to re-establish its position and for this to happen, expects to produce over 4mbpd although has since been reduced to around 3.8mbpd. There is another and more serious issue for Saudi. Will Donald Trump push ahead and allow US citizens to bring actions against Saudi over the 9/11 attacks! There is no tangible proof that the Saudi administration was involved although Saudi nationals were. President Obama vetoed the original proposal.



Iran has an ally in Iraq and the two are working together to defeat ISIS, while the US has its own policy yet, in this respect, they seem to be on the same side for now. Iran has another ally in Russia but when we consider the appalling situation in Syria, Russia and the US are on different sides. Iran and Iraq had been at war with each other for seven years and as a consequence each suffered severe damage to their respective oil production infrastructures. Iraq is rebuilding and making progress, with some US support, but corruption is rife from the top down.

Iran likewise is also trying to re-build now that some sanctions have been lifted, but, with the successful Presidential campaign of Donald Trump there is both fear and uncertainty as to what the US will do in the future. Hassan Rouani, the President would prefer to work more closely with the US but Ayatollah Ali Khamenei the Supreme Leader is more cautious and less trusting while President Elect Trump is an unknown quantity. In spite of concern over the US election result the US Dollar has performed well against a basket of currencies as shown in the adjoining chart.



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Libya seems to be recovering from long-term civil strife and is no doubt looking to increase output to more than 1.5mbpd, a long way above the 350,000bpd at the time of the June Meeting, while today is over 600,000. Nigeria too wants to increase output but corruption and mismanagement means the country is debt laden and with ongoing attacks by militants in the Niger Delta is having difficulty in getting its oil out and away by legal channels. Both countries have been given exemption from output cuts but will no doubt be subject to ceiling levels.

Having taken over the operations of many international oil companies before the price collapse in 2015 Nigeria is now under further pressure to maintain them with oil revenues so depressed. Nevertheless, President Buhari is determined to stamp out corruption and here too, he needs to start from the top. Not only does he have the insurgents in the Niger Delta to deal with but also Boko Haram. Several years ago the Nigerians were confident that they would achieve 3mbpd but have floundered ever since around the 2m level.

We have had months of conjecture with rumours floating around, some from credible sources, others not so credible, as OPEC producers have strived to increase the price without taking decisive action. In recent weeks, members have been meeting each other and supposedly non-OPEC producers too, while in the foreground, Mohammad Barkindo the new and very capable OPEC Secretary General has worked tirelessly vising producers, both OPEC and non-OPEC attempting to broker a deal to bring OPEC output down to between 32.5 and 33mbpd.

As he has built up the air miles, the OPEC Basket oil price has simply fluctuated in a narrow range. Yesterday, Tuesday, the OPEC Basket closed at $43.87, up slightly from the day before at $43.84, but down from $44.88 on Friday and much lower than the price on 19th. October of $49.04. This is a measure for OPEC as the market has followed the dialogue. Brent Crude actually fell on Monday but rose very slightly on Tuesday, not expecting any serious news!

With mixed statements coming from OPEC members that the deal close, we should have expected to see the price move higher, but the market hasn't responded and it did seem that OPEC was about to dig itself into another trough, in a market which it has traditionally been able to control, but no longer. When the Saudi minister announced that with or without the deal the market would find its own level suggested that perhaps there was no point in the deal. On the other hand, perhaps it was to get the dissenters to re-consider their options.

How long the impact will last is an unknown quantity as any price advantage will probably be short lived as the US Shale market and even the North Sea output will come back into the arena while, at the same time, can we trust the OPEC members to honour the commitment they have supposedly made?

As I have said many times before, we did warn OPEC back in 2009 that if the price was pushed up to over $100, three things would happen – Demand destruction, Energy Conservation and the rise of alternative fuels. All three came true as demand peaked within the OECD sector while energy conservation and renewable energy moved in together with the advent and rise of Shale production in the US.

Back in December 2014 when this all began, OPEC surprised us by stating that it would keep pumping to maintain market share. Saudi Arabia took the lead and although the rest of them couldn't answer they had to go along with it. Iran and Iraq were both struggling then in terms of output but as the situation in Iraq improved and sanctions were lifted on Iran, each was able to move ahead and plan for increased output.

We cannot forget that back in 2012, Iraq announced that it would be aiming for something like 12mbpd by 2017! Some way off today but that was the dream then. In fact, before the war with Iran, each of them had the potential to produce around 6mbpd. With hindsight, had the war not happened the overall position within OPEC today could be very different indeed.

We rolled on to the meetings in June and December 2015 with OPEC resolute that it was on track and would continue the policy and it wasn't until April of this year that rumours set off a chain of events culminating in the meeting in Doha of some OPEC members including Saudi Arabia and also Russia.

Ali Naimi the Saudi Oil Minister at the time, realised what the cost had been to the Kingdom of this strategy. There was some talk of a deal then but as there was no plan in place to even set up the meetings in advance the process floundered and in true OPEC style the announcement was made that they would continue to follow the market until the next scheduled meeting in June. However, Naimi did seem keen on a plan but was unable to take it any further and was seemingly retired off and replaced by Khalid al-Falih.

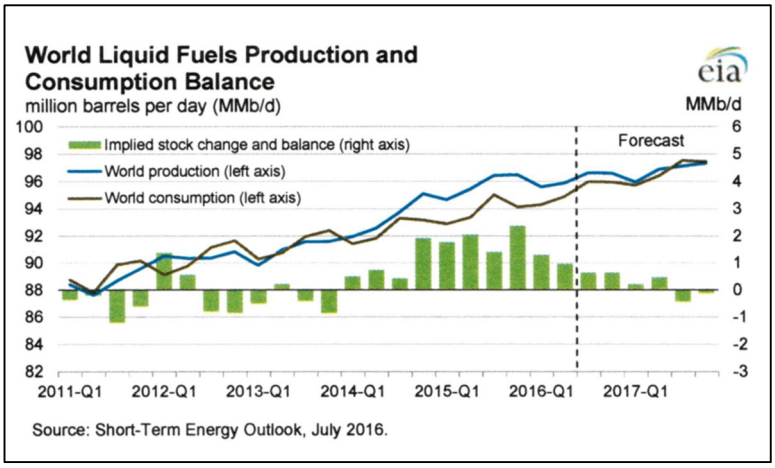
Back home, the new deputy Crown Prince, Mohammed bin Salman, a man of thirty-one, had the plan to restructure the way in which the Kingdom managed itself and to wean it off its sole dependency on oil revenue. Something that should have happened many years earlier and something that his seniors probably never considered.

The Policy of maintaining and increasing output has had an adverse effect on all producers and whereas Saudi believed the outcome would be quicker and that it could outlive its competitors. Had OPEC held production closer to 32mbpd, the plan would have achieved the objective. As a consequence of the overproduction it has not and all is not well in Saudi. Salaries of senior public employees have been cut by 20% and subsidies are being reduced too while the unemployment situation in the country is causing concern. So, what is happening lower down

the scale? All producers are in trouble and without a concerted effort to exercise some control, more oil will come to the market and prices will fall further.

At the June Meeting, in spite of an extended session of discussion between members, they announced that the market was performing well and that they would take no further action and continue to monitor it until the next meeting in November! From June it was rumoured that OPEC would meet in September.

In fact, it was at the International Energy Forum that most of them happened to be there and Russia too and although there was never an OPEC Meeting Scheduled, with the Secretary General arriving the 170th. Extraordinary Meeting evolved.



The 170th. Meeting was the ideal opportunity for them to catch up on any lost opportunity from June and put something in place to be ratified at the November Meeting.

Even so, by then the US Energy Information Administration (EIA) had published its Short-Term Energy Outlook showing that supply and demand were still forecast to balance in 2017.

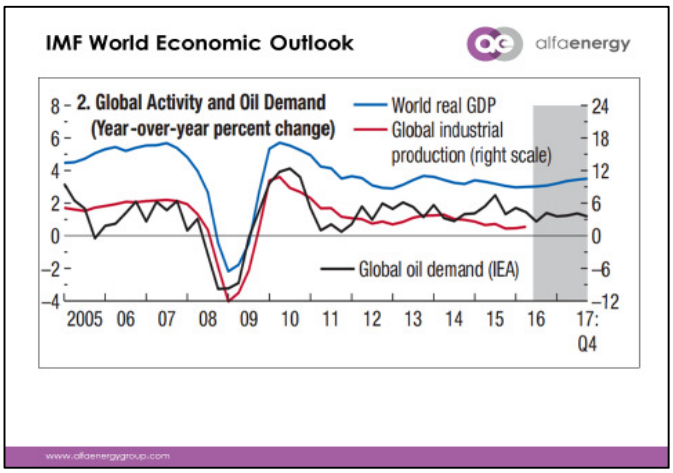
The discussions centred around the 170th. Meeting were based excess supply and with OPEC continuing to overproduce there was deemed the need to exercise some level of control. In the Table below we have illustrated how key market indicators have moved since the initiative taken in December 2014 and such numbers would have influenced OPEC thinking.

There has been some updating since June but overall the figures have changed only marginally since the IEF meeting in September. Brent, WTI and OPEC prices have all fallen by more than 30% while the US Dollar is now stronger by 12%, against a basket of currencies and some of this is no doubt due to the successful election of Donald Trump as US President.

The plan had been to hit non-OPEC suppliers like the US Shale market and her the rig count is down by 75% but as prices have started to rise, so too has the rig count. The bad news for OPEC is that their output has continued to rise, now at 13%, like US and OECD stock levels at 11 and 9% respectively.

KEY Estimates				
Data Source	**Dec 2014**	**Dec 2015**	**Nov 2016**	**Change**
Brent Crude	**$72.54**	**$44.81**	**$47.10**	**-35%**
WTI	**$69.00**	**$41.83**	**$45.95**	**-33%**
DXY Dollar Index (month end)	**90.269**	**98.631**	**101.05**	**+12%**
OPEC Basket	**$66.44**	**$39.30**	**$44.88**	**-32%**
OPEC Output	**30.03mb**	**32mb**	**33.82mb**	**+13%**
North America Oil & Gas Rigs	**1,917**	**744**	**474**	**-75%**
EIA US Stocks	**1.859bn**	**2.014bn**	**2.062bn**	**+11%**
US Crude Production	**9.4mbd**	**9.3mbd**	**8.74**	**-7%**
OECD Stocks	**4.3bn**	**4.6bn**	**4.7bn**	**+9%**
Data Source: Baker Hughes, OPEC EIA, IEA, Thomson Reuters* Nov-16 or Latest				

What has been so incredible about this whole process is the speed with which it has developed, running since April leader or minister interviewed has issued he same platitudes that they are very supportive of the plan and the need to bring supply and demand closer in to balance while providing themselves, and other producers, with a higher price. They have accepted for now that probably $60 is as much as they could hope for and that the days of $100+ are long gone.

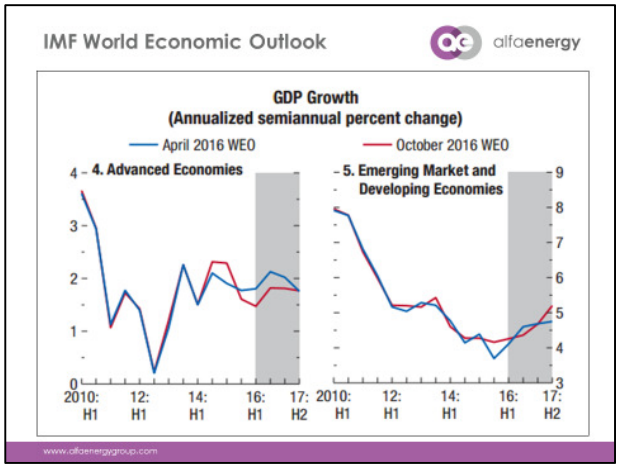


In recent days, aspirations have swung from one extreme to another. On Monday, Goldman Sachs said a deal had a 30% chance of happening but by yesterday, Tuesday, they expected it to happen and revised their forecast accordingly. A forecast therefore, may be good for a day or two but one cannot count on it lasting in such times.

Looking back at the forecast set by the International Monetary Fund (IMF) in July the view was that World GDP would increase

gradually across 2016 and 2017 while global oil demand would remain stable.

Not perhaps what OPEC wants to hear but the world is moving on and we are now hearing that "Peak Demand" for oil will come sooner than "Peak Supply". The next chart also taken from the World Economic Outlook shows how the forecasts for April of GDP for Advanced and Emerging economies have fared by October.



Although the figure for the Advanced sector has not performed as well as anticipated it did improve and finish on target while the Emerging economies continued the thrive and as OPEC knows, this is where their markets lie in future – they must look to Asia and the East and no longer to the West.

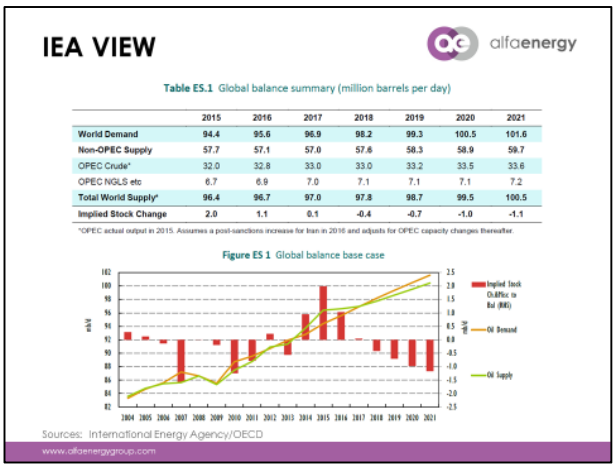
From the Monitoring Committee Meeting of OPEC last week came the view that output would need to be cut by around 1mbpd, spread across the OPEC members and non-OPEC producers and all heads of state and oil ministers have been united in the view that there has to be a deal. The problem has been that no one really wants to commit!

Algeria has put forward the deal to the individual members and the fundamental difficulty is – what are the true output numbers? They didn't know! OPEC Members mistrust third party figures and they also mistrust their own fellow members' figures! Who to believe? OPEC will publish figures submitted by the members and then third party estimates are produced from analysts and media sources which are usually different.

For Iran to restrict its output, a figure close to 4mbpd was supposedly wanted, but the figure suggested was nearer 3.7mbpd. A compromise was needed and something around 3.8 may suit. What is fundamental is that Iran wants the right to return to its pre-sanctions level of 4.2mbpd. It cannot produce that amount but as a matter of principle does not wish to concede on the level that it believes it should rightfully have. Iraq argues that it is fighting ISIS and needs all of the oil it can produce while also saying it will support the OPEC initiative, but the only way it can give support, is to agree to cut! It may accept a figure based on its October figure around 4.5mbpd.

Then of course, both Iran and Iraq wanted to see the Saudi figure reduced from 10.6mbpd to something closer to 10mbpd. Give and take, but Saudi doesn't want to be the one to give more than the rest, it wants a fair and equitable deal. The three of them were key to the deal, with the

rest falling in to place with Libya and Nigeria excluded as they rebuild while the figures agreed, may be open to question and abuse.



IEA VIEW

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Table ES.1 Global balance summary (million barrels per day)

	2015	2016	2017	2018	2019	2020	2021
World Demand	94.4	95.6	96.9	98.2	99.3	100.5	101.6
Non-OPEC Supply	57.7	57.1	57.0	57.6	58.3	58.9	59.7
OPEC Crude*	32.0	32.8	33.0	33.0	33.2	33.5	33.6
OPEC NGLS etc	6.7	6.9	7.0	7.1	7.1	7.1	7.2
Total World Supply*	96.4	96.7	97.0	97.8	98.7	99.5	100.5
Implied Stock Change	2.0	1.1	0.1	-0.4	-0.7	-1.0	-1.1

*OPEC actual output in 2015. Assumes a post-sanctions increase for Iran in 2016 and adjusts for OPEC capacity changes thereafter.

Figure ES 1 Global balance base case

Sources: International Energy Agency/OECD

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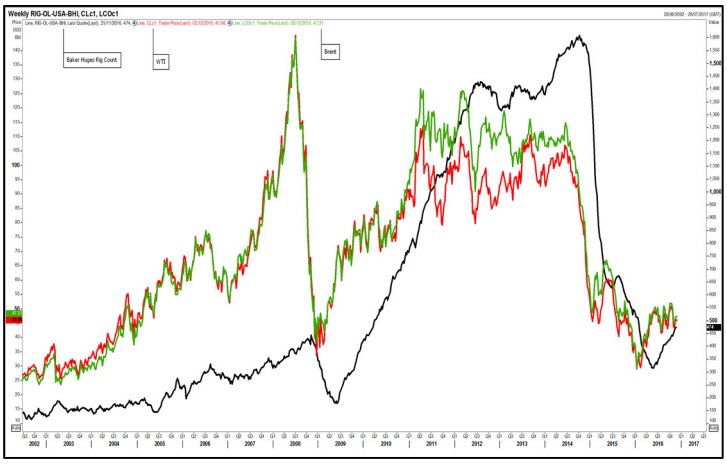
There was a meeting scheduled to include non-OPEC producers for Monday, but towards the end of last week, Saudi announced that it would not be attending saying there was no point until a deal had been put in place within OPEC. Similarly, Russia said it wasn't attending and so the ministers from Algeria and Venezuela set off to Moscow. What they hoped to achieve was questionable. The Russian oil minister would follow orders from President Putin and any dialogue with other countries would have to be at presidential level.

Surprisingly, over the weekend Khalid al-Falih, the Saudi oil minister calmly announced that the cut wasn't really necessary as the market would balance anyway! My guess is that this was to make the dissenters realise that prices would not change and would probably fall if they did not contribute to the plan. The chart above was taken from the International Energy Agency (IEA) earlier in the year when they too forecast like the EIA that the market would balance in 2017.

The telephone call between President Putin of Russia and President Rouhani of Iran. There was much to talk about, particularly the geo-political tension in the Middle East, Yemen and Syria and of course they would have touched on the oil market. Each said they would support the deal but neither said how. Russia is increasing output which is now just over 11mbpd and because of the frozen terrain in which it operates, one understands that it cannot easily cut.

Again, we have to accept that Saudi Arabia needs non-OPEC support but unlike previous occasions will not take the burden of cut and let the others plunder its market, although that is an option in the short term, to put out some kind of a deal to let the market at large know it is serious. So with the oil price wavering and the chance of the deal lost, OPEC has made the decision to cut and finally pulled it off. As the price now rises towards $55 and maybe above, what next? The reason why they decided



two years ago not to cut, was to cripple the US Shale industry and demonstrate to non-OPEC producers that there needed to be some control in the market to safeguard against oversupply.

Non-OPEC producers have been quick to cut costs and streamline their operations. North Sea operators have virtually halved their costs and increased output even at lower price levels. US stocks are still high, affording a supply cushion should the price rise but the shale infrastructure is still there and it is warming up to return and the really bad news for OPEC is shown in the adjoining chart in which we can see the Rig Count reviving and moving up in line with price.

OIL MARKET AHEAD alfaenergy

- Forecast Outlook Monthly Reuters Poll: November 2016

Brent Crude $/BBL	Q4-16	2016	2017
Average	50.00 (N/C)	56.25 (44.74)	64.00 (57.28)
High	65.00 (N/C)	83.00 (50.00)	80.00 (83.00)
Low	40.00 (N/C)	47.50 (42.00)	52.50 (47.50)

- Reuters composite Brent monthly oil forecast 28 contributing sources (predominately investment banks. October figures in brackets
- In light of recent developments all price levels have been increased which is surprising taking in to account the lack of confidence the market tends to have on OPEC's ability to manage output and price.
- Conversely, prices could fall if a sustainable deal does not materialise
- Likewise, if a deal does materialise, we can expect to see increased output from all sources, particularly US Shale, Russia and North Sea

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In spite of the uncertainties there has to be a level of forecasting. Looking ahead in terms of market aspirations there will be a chance for prices to increase as shown in the attached chart compiled by data from Thomson Reuters. I said after the June Meeting that I didn't feel prices would move in the $50-55 range and this is how it has been.

The extent to which it moves now will depend upon the full agreement on 9th. December and thereafter the market will no doubt take in to consideration the OPEC effectiveness at adhering to "quotas". With the price of Brent around $50 tonight we can probably expect more volatility as producers continue in their plight to manage their output and perhaps if they are successful and the price does move up, we shall see the Shale and North Sea markets make a return and the US will plan more exports. $60 is an aspiration for OPEC and we may see that but overall as of now, I do not foresee a dramatic rise in prices in the short term. If the producers can make it work a hold out until May, then there may well be higher prices but that is less likely to happen in my view.

So, whatever we can take away from this historic OPEC Meeting is the knowledge that it may not last and that within the next six months OPEC will re-appraise and revise its strategy. Iran, Iraq and Russia are working well together outside the oil market and could formulate their own plans leaving Saudi. Prices will rise but so too will non-OPEC output. As always, I hope I have given a balanced view in this report, much of it written in great haste. Some will agree and others may not but if there are any points that you would like to discuss with me, please let me know. The next OPEC Meeting has been scheduled for May 2017. I shall be following events in the meantime and expect to be there.

Any comments or queries, please contact me – John Hall, John.Hall@Alfaenergy.co.uk +44 7880 367773 or + 44 7785 274530.