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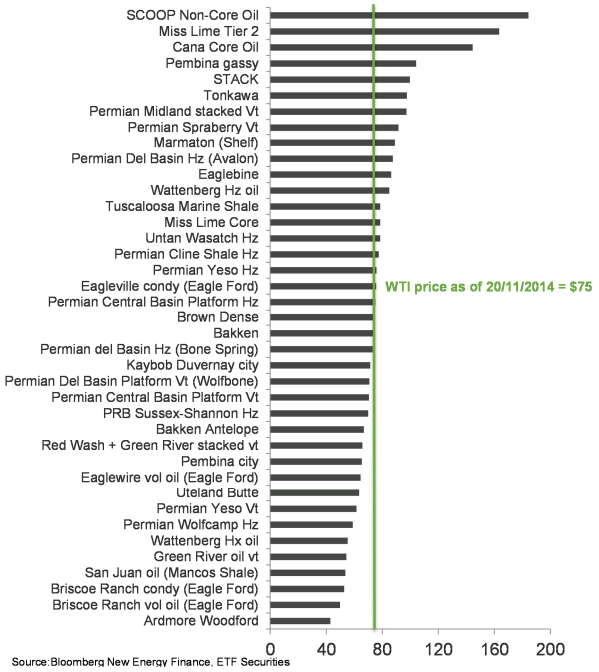
OPEC UNDER PRESSURE AS OIL PRICES REMAIN BELOW US$80/BBL

FALLING OIL PRICES ARE TESTING OPEC UNITY AS THE NOVEMBER 27 MEETING LOOMS

- Oil prices have fallen by over 20% since the end of August, as OPEC is alleged to have started a price war to maintain its market share in light of the rapid growth of shale oil in the US in recent years.
- Ultimately, the key to greater support in oil prices lies with OPEC and we believe that the oil cartel, which has been in existence since 1960, will not fall apart and will eventually commit to cutting back on oil production.
- While US production is abundant, with oil production at multi-decade highs there is little potential for US crude exports in the near-term, capping the negative impact the over-supply in the US has on global prices.

WTI crude and Brent are now trading over 20% below the US$100/bbl level that is considered a "fair price" by most OPEC producers and that has historically been defended by the OPEC. While weak global demand for oil and distillates combined with ample global supply of crude has weighed on both Brent and WTI prices over the past few months, OPEC inaction contributed to push oil prices below US$80/bbl. OPEC has historically played a fundamental role in keeping oil prices above US$100/bbl. However, OPEC members entered a price war in October, selling their oil at a discount in Asia and the US in order to retain their market share.

Breakeven Thresholds for US Shale Projects (US$/Bbl)



Source:Bloomberg New Energy Finance, ETF Securities

The key to greater support in oil prices lies with OPEC. According to OPEC's Secretary General, US shale oil producers will be the most hurt by persistently low oil prices while OPEC will be broadly unaffected. While different oil fields have different breakeven costs, most US shale oil, which accounts for most of the global oil production growth over the past few years, has a breakeven price in the range of US$60-US$80. According to the IEA, 82% of crude oil and condensates production from the United States has a breakeven price of US$60/bbl or lower. However, the majority of OPEC countries are estimated to require oil prices of at least US$90-US$100/barrel to balance their government budgets. Hence, we believe it is a matter of time before OPEC start to reduce supply and that could happen as early as November 27, when OPEC holds its next meeting.

There appear to be a clear split between Gulf OPEC members and the remaining countries in terms of cutting oil production to sustain oil prices. Saudi Arabia and other Gulf members have publicly opposed a production cut, while Libya, Venezuela and Ecuador have urged oil price support ahead of the next OPEC meeting. Currently OPEC produces 30.5mn barrels per day, 0.5mn barrels above the current production ceiling of the organisation. Most non-Gulf members are calling for Saudi Arabia to bear the brunt of the supply reduction as they allege that is where the majority of the overproduction comes from.

With the future of the Organization of the Petroleum Exporting Countries at risk, we believe Saudi Arabia will have to cut production in order to soothe the increasing restlessness of the other OPEC members. We reiterate our positive view on both Brent and WTI and believe prices will recover from current low levels. (Click here for our Trade View on Oil).

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