Session 2

Energy Markets: Mitigating Volatility

*Keynote Speech*

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Large price swings

- In the late 1990s, oil prices plunged below $10/b
- OPEC underscored that this is detrimental to producers and, in the long-run, to consumers
- The industry undertook deep cost-cutting strategies: investment stalled and workforce shrunk
- OPEC’s spare capacity proved very helpful when oil demand rebounded
- Greater daily price changes since 2007
Since 2004, a new phenomenon: the financialization of commodity markets

- Since 2004, participation of financial players has grown dramatically
- Greater diversity of financial investors
- Varied and complex player strategies, such as:
  - Hedge against inflation
  - Hedge against currency fluctuations
  - Portfolio risk management
  - Arbitrage
  - Index tracking
  - Speculation

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*Excluding precious metals
Source: Bank for International Settlements*
NYMEX light sweet crude oil: large increase in open interest

* Each contract is 1,000 barrels
Mitigating volatility: increased awareness and ongoing actions

The question: does increased participation of financial investors alter the proper functioning of oil markets in terms of price discovery and risk transfer?

Increased awareness: the Jeddah Energy Meeting in June 2008

Regulatory reforms underway

Agreed areas of cooperation among IEA, IEF and OPEC: a successful implementation
- Two Workshops held on the interactions between financial and physical markets
- A Forum on energy markets regulatory reform
- Two Workshops on energy outlooks

Joint Organisations Data Initiative
- Great achievements in 10 years
- Further strengthening is warranted
World energy demand by fuel type in the Reference Case

- Energy demand to increase by 51% by 2035
- Fossil fuels will continue to satisfy the major share of energy needs
- Sufficient resources
- The overall share of oil will decline
- Diversity of oil supply
Scenarios stress uncertainty over future oil demand

Large differences in oil demand between scenarios…

…and this points to a wide range of cumulative OPEC investment needs
In summary…

- Extreme volatility and excessive speculation detrimental to all

- Need for:
  - Well-designed regulatory reforms
  - Further strengthening JODI
  - Advancing academic research

- The importance of the producer-consumer dialogue
Thank you

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