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## Oil market & budget developments

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- Crude prices rebounded from mid-December lows on fears that Iran could disrupt oil trade through the Strait of Hormuz. In euro-terms, oil prices are now close to or above their mid-2008 highs.
- Oil supplies are set for a decent sized increase this year, partly driven by an increase in OPEC NGLs. This should lead to an easing in previously tight oil market fundamentals.
- An average oil price of \$104-107 pb would yield a budget surplus of KD 9-11 bn for Kuwait in FY2011/12, following a KD 5 bn surplus last year.

### Oil prices

After dipping in mid-December, crude oil prices bounced back in early January, with some blends hitting fresh 8-month highs. From a December 19<sup>th</sup> low of \$101.9 per barrel (pb), the price of Kuwait Export Crude (KEC) climbed \$11 to \$112.8 three weeks later. Brent crude rose by a similar amount to \$114.5. Meanwhile, the price of West Texas Intermediate (WTI) – whose discount to Brent has narrowed by two-thirds in recent months – climbed \$10 to \$103.2.

Overall, 2011 was a record year for oil prices. Brent averaged \$111.2 pb, its highest ever and a 40% increase on 2010. WTI – which traded at a heavy discount to Brent for much of the year – saw a smaller rise of 19%, averaging \$94.9. KEC averaged \$105.5, up 38% on 2010. Despite reaching these record levels, prices stood well off their intra-year highs of \$140+ seen in mid-2008.

The rebound in prices in early January owed much to the ramping-up of tensions between the international community and Iran. The latter has threatened to disrupt oil travelling through the Strait of Hormuz, which accounts for as much as 17 million barrels per day (mbpd), or 40%, of all seaborne traded crude, as well as all of Qatar's liquefied natural gas (LNG). Analysts are divided over the impact – and duration – of such an event on oil prices. But since most of the region's hydrocarbon exports travel east, any disruptions would be most likely felt in physical markets in Asia.

It is also worth noting that the climb came despite a sharp increase in the value of the US dollar against the euro, which would normally be bearish for crude. The greenback has appreciated 5% against the euro since the end of November, partly on selling of the Euro zone's currency in the so-called 'carry trade'. Little noticed, this has pushed euro-denominated oil prices for some blends above their mid-2008 highs.

### Oil demand outlook

Large divisions have emerged among analysts over the outlook for global oil demand as well as what actually happened last year. Although the latter is backward looking, it still has implications for oil balances and overall market tightness. At one end, the Centre for Global Energy Studies (CGES) is pessimistic, estimating oil demand growth of just 0.6 mbpd (0.6%) in 2011 and 0.7 mbpd (0.8%) for 2012, based upon

Chart 1: Kuwait export crude scenarios, \$ pb

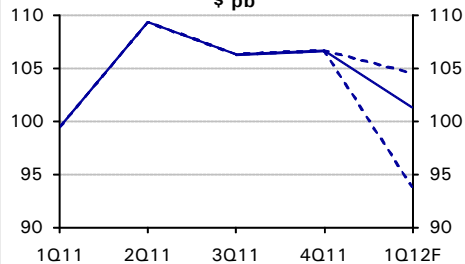


Table 1: KEC price scenarios (\$ pb)

	Low	Mid	High
2010	76.2	76.2	76.2
1Q11	99.4	99.4	99.4
FY10/11	82.5	82.5	82.5
2Q11	109.3	109.3	109.3
3Q11	106.3	106.3	106.3
4Q11	106.6	106.6	106.6
2011	105.4	105.4	105.4
1Q12f	93.8	101.3	104.5
FY11/12f	104.0	105.9	106.7

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economic weakness in the developed world and a sharp slowdown in Chinese growth. Other institutions see oil demand growth of more than 1 mbpd in both years. Both OPEC and the International Energy Agency sit somewhere in the middle, expecting growth last year of 0.7-0.9 mbpd, followed by a stronger 1.1-1.3 mbpd in 2012. Most forecasters emphasize the possibility of slower demand growth if, for example, the US economy were to turn out weaker than expected or were the situation in the Euro zone to deteriorate further.

### Oil supply outlook

**Crude oil output of the OPEC-11 (i.e. excluding Iraq) jumped by more than 500,000 bpd in November to 27.69 mbpd.** The rise was mainly due to the continued surge in Libyan output, which rose by 222,000 bpd to 0.57 mbpd. This is still well short of its 1.6 mbpd pre-war level, although output is said to have reached 1 mbpd since November and full production is expected to be restored by mid-year. Other large increases were seen in Nigeria (+83,000 bpd) and Saudi Arabia (+175,000 bpd), the former a rebound from the effects of pipeline sabotage a month earlier.

At its meeting in December, OPEC agreed to set total production at 30 mbpd (including Iraq), down from a reported 30.4 mbpd in November. But it avoided imposing potentially awkward country quotas, in a likely attempt to restore unity after its acrimonious meeting in June. With Libyan output returning, the latest production target could imply cuts in production from those countries (largely in the GCC) that increased production to offset Libyan losses in 2011.

**The consensus view is for an increase in non-OPEC supplies of at least 1 mbpd in 2012,** though up to half of this is expected to come from OPEC natural gas liquids (NGLs), which are not subject to OPEC targets or quotas. This is after the impact of the IEA's June 2011 60 million barrel stock release, which will in effect reduce supply growth next year by 0.2 mbpd. If OPEC achieves its 30 mbpd target, total global oil supplies should climb by 1.3-1.8 mbpd in 2012.

### Price projections

**If the CGES's more pessimistic demand projections prove accurate, then supply growth could significantly outpace the increase in demand this year.** This will weaken market fundamentals, but by less than it appears given that the market was starting from a position of supply deficit and inventory draw downs. If non-OPEC supplies rise by 1.1 mbpd (including OPEC NGLs) and OPEC meets its 30 mbpd target, we may see a modest stock-build of 0.4 mbpd in 2012. In this scenario, the price of KEC could slide from \$107 in 4Q 2011, to below \$80 in 4Q 2012.

**If, on the other hand, non-OPEC supplies rise by 0.4 mbpd less than expected this year and OPEC keeps its production targets unchanged, oil prices could remain above \$100 pb.** Indeed, prices could rise steeply towards the end of the year. Concerns about the impact of high prices on a fragile world economy could ultimately see OPEC boost production. This scenario of course still assumes no disruption to oil trade in the Strait of Hormuz, which is a separate upside risk to prices.

**The main downside risk to prices clearly comes from a much weaker than expected global economy.** Oil demand could grow by as little as 0.3 mbpd (0.3%) this year. Assuming that this is not met by prompt OPEC output

cuts, prices could see big falls this year. In this case, the price of KEC falls to \$80 pb in 2Q 2012, and to under \$60 pb by year-end.

### **Budget projections**

With less than three months remaining in fiscal year 2011/12, the impact of the scenarios above will largely be felt next year. The scenarios imply fiscal year average oil prices of between 104 and \$107 pb this year, an increase of 26-29% on a year earlier. If as we expect, spending comes in at 5-10% below the government's forecast, **the budget could see a surplus of between KD 8.5 billion and KD 10.5 billion** before allocations to the Reserve Fund for Future Generations. This is KD 3-5 billion higher than last year's surplus, and would represent Kuwait 13<sup>th</sup> successive budget surplus. □

**Table 2: Budget forecast, KD million unless otherwise stated**

	Under alternative price scenarios					
	FY 2010/11		FY 2011/12			
	Official budget	Actual	Official budget	Low case	Base case	High case
Oil price (USD/pb)	43.0	82.5	60.0	104.0	105.9	106.7
Total revenues	9,719	21,502	13,445	26,951	27,444	27,991
Oil revenues	8,617	19,947	12,307	25,813	26,306	26,853
Non-oil revenues	1,102	1,555	1,138	1,138	1,138	1,138
Expenditure (official)	16,160	16,221	19,435	19,435	19,435	19,435
Surplus	-6,441	5,281	-5,990	7,516	8,009	8,556
After RFFG	-7,413	3,131	-7,335	4,821	5,265	5,757
Expenditure (NBK)	-	-	-	18,463	17,977	17,492
Surplus (NBK)	-	-	-	8,488	9,467	10,500
After RFFG	-	-	-	5,793	6,722	7,701



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