BBC NEWS

# Why Opec wants production cuts

**Analysis**
By Andrew Walker
BBC economics correspondent at the Opec meeting in Vienna
**Oil prices are close to a 13-year high and the producers' organisation Opec is talking about cutting supplies.**

Comments from energy ministers attending the meeting in Vienna suggest they might well decide to go ahead and implement a cut in official output quotas agreed last month, due to come into effect on 1 April.

It sounds perverse and it certainly is not going down well in Washington, where petrol prices have become a political issue.

There seem to be three main concerns driving Opec talk of production cuts:

**Time of year:**

The northern hemisphere is where the big energy consuming countries are, and with the end of winter, demand for heating oil drops sharply.

There is a lull before the summer driving season gets in gear, when sales of petrol start to pick up.

Opec wants to ensure that the drop in sales of refined oil products does not lead to a corresponding drop in what its members get for their crude oil.

**Speculation:**

Opec makes something of a habit of blaming speculators in commodity markets whenever oil consumers complain about high prices.

This time, analysts say they do have a point.

They say speculators have been buying oil contracts and if they decide to sell that could drive the price down - something Opec is keen to avoid.

**The dollar:**

The US currency has been declining for more than three years against some currencies, notably the euro.

Oil is priced in dollars, so the exchange rate does affect the purchasing power of what Opec members get paid.

Some members of the group, notably Nigeria, have suggested there should be a higher target price for Opec's oil to compensate for the lower dollar.

**High prices**

But if the group does agree to go ahead with the production quota cut, will they implement it?

Probably not, according to Roger Diwan, of the Washington consultancy PFC Energy.

He says only Saudi Arabia has shown any meaningful signs of preparing to reduce oil sales.

Instead, most analysts think for the time being Opec members will continue to enjoy the rather high

price.

And by recent standards it is quite high.

In dollar terms the price has been hitting its highest levels since the run up to the early 1990s Gulf War - a time when Iraqi and Kuwaiti production had disappeared from the market.

**Long term implications**

There are some economists who warn that a high oil price could damage the global economic recovery, now underway after two or three years of rather slow performance.

Julian Lee of the Centre for Global Energy Studies, a London research agency, says that the impact seems to be fairly long term if prices remain high for some time.

So we will not see the real impact of the high oil prices of the last six to 12 months for another year or so, he says.

But to keep it all in perspective, in real terms, allowing for inflation, the price of crude oil is far below the peaks it reached in the early 1980s.

And some observers argue that it is important to remember that current prices are less the result of supply restrictions than strong demand - especially from the US and China.

In the US, the recovery from the 2001 recession gathered pace in the latter part of last year.

In China, continued strong growth in energy hungry industries has increased the demand for energy - to such a point that some businesses do not want to rely on the public electricity supply, according to Julian Lee.

So some are looking at building their own power plants, typically using oil.

In the long term, he says, China will want to develop its own energy resources - notably coal and hydro-electricity.

But for now, Chinese demand is an important element in the global oil market.

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