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OPEC Investment Strategies – Past and Future

by Hamid Bagh-shomali, San Francisco*

Some forecasters recently have predicted that OPEC countries with continuing current account surpluses will shift from long-term to short-term investments in the near future to improve their liquidity positions. However, careful study of a variety of data, including historical patterns, suggests that this will not be the case. Instead, surplus countries will turn even more to long-term investments offering higher returns over time.

In addition to historical patterns, the argument for an increase in long-term investments rests on a projected improvement in OPEC's current account as the demand for OPEC oil increases in late 1982 and 1983 in tandem with global economic recovery, and the continued decline in interest rates which began in late 1982. This outlook assumes that during the forecast period no widespread conflict will occur in the Middle East, with disruptive consequences for the oil supply. For the long run, indications are that income from direct and indirect foreign investments will play an increasing role in fulfillment of economic strategies.

To preface examination of the historical pattern: three surges in oil pricing have occurred since 1973 (see Table 1), with figures reflecting year-over-year averages:

- a 238 % increase in 1974, due to the Arab boycott program in the wake of the Arab-Israeli war of October 1973;
- a 44 % increase in 1979, based on reduced Iranian output due to the revolution;
- a 65 % increase in 1980, due to the Iran-Iraq war and further reduction in output from the Mid-East.

A tenfold price hike since 1973 and a torpid world economy have caused importing nations to conserve and world oil production to fall to 55.7 million barrels a day in 1981 – almost equal to the 55.1 million barrels of 1973, after a 62.6 mb/d peak in 1979. The OPEC bloc is

also experiencing a declining share of output, with the development of competing sources of oil and alternative energy by other nations. In 1973, OPEC produced 55.4 % of the world's oil, or 72.3 % if production by the centrally planned economies is excluded. In 1981, the ratios fell to 40.7 and 54.6 % respectively. The price per barrel in 1981, however, was \$ 34.50 versus \$ 3.4 in 1973.

Investment Preferences

During the surge years of 1974 and 1979, OPEC investments were clearly made short-term, almost 70 % in 1974 and 71.3 % in 1979 (see Table 2). On a year-to-year basis, the geographic placement of assets appears to have followed the general trend of all investors, moving funds according to perceived changes in the trade-offs among interest rates, inflation, and country risk. A definite longer term trend toward country diversification, however, can be noted by comparing patterns between the early and late surge years. In 1974 and 1975, the combined short-term OPEC deposits in the United Kingdom and United States accounted for 75.4 and 47.9 % of all short-term investments. US banks alone received over 11 % of these investments in both years – in addition to their Eurodollar business (see Table 3).

For the years 1979 and 1980, however, the two-year pattern changed, with UK and US investments dropping to 56.7 and 38.3 % respectively. Other industrialized nations – notably Germany and Japan – received the difference. One can speculate that the US freeze placed

* Bank of America

OIL FUNDS

Table 1
World Oil Production
(millions of barrels per day)

	1973	1974	1975	1976	1977	1978	1979	1980	1981
OPEC	30,525	30,231	26,695	30,148	31,225	29,807	30,928	26,890	22,667
Industrialized Countries	11,700	11,200	10,700	10,700	11,346	12,196	12,757	12,859	12,879
Non-OPEC LDCs	2,980	3,035	3,285	3,440	4,089	4,431	4,951	5,457	5,931
Centrally Planned Economies	9,918	10,744	11,532	12,236	12,996	13,675	13,963	14,239	14,234
World Total	55,123	55,210	52,212	56,524	59,656	60,109	62,599	59,445	55,711
OPEC Production in % of World Total	55.4	54.7	51.1	53.3	52.3	49.6	49.4	45.2	40.7
OPEC's Annual Average Price (US \$)	3.40	11.50	11.30	11.51	12.88	12.93	18.67	30.87	34.50

Source: Central Intelligence Agency: Economic and Energy Indicators.

Table 2
Deployment of Oil Exporters' Surpluses
(in US \$ billion)

	1974	1975	1976	1977	1978	1979	1980	1981 ^a
Identified Investable Surplus	53.2	35.2	37.4	33.3	13.3	60.6	87.0	46.0
Short-term Investments	36.6	9.5	13.3	11.6	4.0	43.2	42.5	8.3
in the US	9.4	1.1	1.8	0.4	0.8	8.3	0.2	9.5
in the UK	18.2	3.4	5.0	3.7	-1.8	16.2	16.1	-1.9
(of which Eurocurrency Deposits)	(13.8)	(4.1)	(6.4)	(3.4)	(-2.0)	(14.8)	(14.8)	(9.0)
in other Industrialized Countries	9.0	5.0	6.5	7.5	5.0	18.7	26.2	0.7
Long-term Investments	16.6	25.7	24.1	21.7	9.3	17.4	44.5	37.7
in the US	2.3	8.5	10.4	8.8	0.6	-1.5	14.3	13.7
in the UK	2.8	0.9	-0.5	0.2	0.0	1.0	2.0	0.7
in other Industrialized Countries	3.1	5.8	12.2	12.4	8.6	8.7	16.7	15.8
in Developing Countries	4.9	6.5				9.6	6.6	5.3
with International Institutions	3.5	4.0	2.0	0.3	0.1	-0.4	4.9	2.2
Percentage of Short-term Investments	68.8	27.0	35.6	34.8	30.0	71.3	48.9	18.0
Percentage of Long-term Investments	31.2	73.0	64.4	65.2	70.0	28.7	51.1	82.0

^a Estimate

Source: Numerous quarterly bulletins of Bank of England.

Table 3
OPEC Investments in the United States
(in US \$ million)

	Investment flows								Investment position (year-end)	
	1974	1975	1976	1977	1978	1979	1980	1981	1980 ^r	1981 ^p
US Government Securities	6,359	3,492	3,970	4,426	-2,311	2,102	11,018	12,147	28,150	40,297
Treasury Bills & Certificates	5,280	458	-1,044	-852	-938	3,341	1,380	-522	8,017	7,496
Treasury Bonds & Notes	195	1,967	4,253	4,320	-1,499	-1,155	8,188	10,861	15,734	26,595
Federal Agency Issues	884	1,067	761	958	126	-83	1,450	1,808	4,398	6,207
Corporate Bonds	2	498	419	736	702	508	2,049	1,665	4,847	6,512
Corporate Stocks	219	1,652	1,828	1,408	792	672	1,202	1,152	8,079	9,231
Commercial Bank Liabilities	4,158	629	1,903	401	792	5,083	-1,160	-1,889	14,285	12,397
Demand Deposits	n/a	44	802	328	-74	1,930	-28	-1,573	4,614	3,041
Time Deposits	n/a	-514	-488	18	880	215	41	938	2,225	3,163
Other ^r	n/a	1,099	1,589	55	-14	2,937	-1,172	-1,254	7,447	6,192
Subtotal ²	10,738	6,271	8,120	6,971	-25	8,364	13,109	13,075	55,361	68,437
Nonbank Liabilities ²	494	754	515	8	218	-308	106	-184 ⁵	2,123	1,939 ⁵
U.S. Government Liabilities ^{3,4}	132	944	2,480	392	51	-988	626	292 ⁵	3,796	4,088 ⁵
Direct Investment ³	111	-32	-6	-10	110	19	197	50 ⁵	576	626 ⁵
Total Investment in the US	11,475	7,937	11,109	7,361	354	7,087	14,038	13,233	61,856	75,090

n/a Not available.

^r Revised.

^p Preliminary.

¹ Includes negotiable time certificates of deposits.

² OPEC plus Bahrain and Oman.

Note: Detail may not add to total due to rounding.

Source: US Department of Commerce.

³ OPEC.

⁴ Position consists of cumulative flows from 1972.

⁵ Through third quarter.

Table 4
Demand and Supply Projections for Crude Oil
(millions of barrels per day)

	1982	1983
World Demand for Crude Oil	55.5	56.4
Non-communist	42.4	43.2
Centrally Planned	13.1	13.2
World Production of Crude Oil	52.6	56.6
Centrally Planned	14.3	14.4
Industrialized Countries	12.8	13.0
Non-OPEC LDCs	6.5	8.2
OPEC	19.0	21.0
OPEC's Annual Average Price	\$ 33.0	\$ 35.0

on Iranian deposits in 1979 contributed to the decision to geographically diversify these assets.

Following each of the oil price shock years, OPEC investment preferences started shifting from short to long-term. Only about 30 % of investable funds were held long-term in both 1974 and 1979, but in the years 1975-78, the ratio reversed, and more than two-thirds of these funds went into long-term financial assets. In 1980, the switch was again evident, with the long-term ratio rising from a 1979 low of 29 % to 51 % that year and 82 % in 1981. After each steep price rise, therefore, the OPEC pattern has been to place the surplus in short-term assets while seeking, and gradually taking advantage of, longer term opportunities.

The United States has been the geographic preference for long-term financial investments. At \$ 57.1 billion through December 1981, these investments represent almost a third of all long-term financial assets held offshore by these countries.

Table 5
OPEC's Projected Trade and Current Account Balances
(in US \$ billion)

	1982	1983
Exports	250	290
Imports	-180	-200
Trade Balance	70	90
Service and Transfers	- 50	- 75
Current Account	20	15

In 1983, oil prices will begin to recover from their current level, which is expected to average \$ 33.00 a barrel for the year. As the industrial economies of the Organization for Economic Cooperation and Development recover, OECD demand for oil should increase by 2 %. Coupled with the restraint of production, as agreed upon at the March 1982 OPEC meeting in Vienna, this will result in a 4 to 5 % increase in nominal prices – to \$ 35.00 in 1983. The price forecast is based on production estimates shown in Table 4.

Continuing Growth of Assets

In view of the above forecast and the fact that OPEC continues to provide more than 50 % of the freely traded energy supplies, the organization will continue to be the dominant force in determining oil prices in the international market for years to come, and its member countries will earn large oil export revenues. Investable surpluses in the bloc's trade and current account balances are projected in Table 5.

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Table 6
Current Account Balances of OPEC and its Middle Eastern Members
(in US \$ billion)

	1974	1975	1976	1977	1978	1979	1980	1981
OPEC	67.8	35.0	40.0	31.1	3.3	68.4	112.2	53.5
Middle East Members	38.0	29.1	33.4	27.7	13.0	44.8	76.2	55.5
Percentage of Total	56.0	83.1	83.5	89.1	394.0 ^a	65.5	67.9	103.7 ^a

^a In 1978 and 1981 non-Middle East OPEC countries incurred deficits in their combined current account. This pattern is forecast to continue in 1982 and 1983.

Source: IMF.

To forecast future investment patterns, it is necessary first to divide the members into appropriate subgroups. Much attention has been given to the distinction between "high" and "low absorber" OPEC nations in reference to population, development programs and country size. However, for purposes of examining investment impact, the distinction among members must be made solely on the basis of current account balances.

Distinctions between OPEC Nations

The non Middle Eastern OPEC nations – Indonesia, Nigeria, Algeria, Libya, Venezuela, Ecuador and Gabon – are classified by most economists as "high absorber" countries, since they tend to expand imports as their export revenues rise. They have shown substantial current account surpluses only during the oil shock years of 1974, 1979 and 1980. Otherwise, the surpluses have been small, and in 1978 and 1981 the accounts were in deficit (see Table 6).

As a group, their deficits should reach a range of \$ 10 to \$ 15 billion in both 1982 and 1983. These economies will therefore be obliged to let their short-term investments run off as well as to continue borrowing in the international capital market.

The Middle Eastern OPEC countries – Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Iran and Iraq – as a group have consistently shown current account surpluses and thus are core sources for global capital markets. Even Iran and Iraq before their destructive war had amassed assets of \$ 25 and \$ 35 billion, respectively. When more normal oil production patterns are resumed, probably in 1983, their surpluses can be expected to begin reappearing, despite the fact that both countries share important characteristics of high absorber countries – relatively large populations and ambitious development programs.

The distinctions between OPEC subgroups therefore clearly lie along geographical lines. The Middle East economies account for over 65 % of OPEC's production. They collectively possess 50 % of the world's proven oil deposits – 360 billion barrels – and

35 % of proven natural gas deposits – 835 trillion cubic feet. They will therefore continue to substantially affect the rate of oil and gas extraction, pricing, and capital markets due to their continuing current account surplus.

As revenues from oil exports increase in conjunction with recovery of the global economies, the need for very liquid assets will decline. Also, the decline in interest rates which began in 1982 indicates that these countries will shift their focus even more from low-yield, short-term assets to higher yield, long-term investments (see Table 7).

Table 7
Projected Asset Preference
of OPEC in 1982 and 1983
(in US \$ billion)

	1982	1983
Short-term Investment	3.5	2.5
Long-term Investment	14.0	11.0
Loans to Developing Countries and International Institutions	2.5	1.5
Total	20.0	15.0

A fundamental shift in asset management reinforces this forecast. The volatile oil markets and the resulting fluctuations in export revenues have given Middle Eastern countries substantial evidence that energy exports do not provide ever-growing sources of foreign exchange. They are thus turning more attention toward generating income from offshore direct and indirect investments. Foreign asset portfolios of an estimated \$ 300 to \$ 350 billion attest to the reliance they are placing on these investments as major sources of funds needed to achieve long-term economic goals.

Kuwait offers an excellent example of the changing policies. Kuwait's 1981 return on foreign assets amounted to \$ 6.1 billion – double that of the previous year. This return accounted for 27 % of Kuwait's total public revenues and 39 % of the foreign exchange earned from oil exports. It can be expected that other Middle Eastern countries, in their efforts to reduce dependence on oil income, will increasingly follow Kuwait's lead.