TD Bank Financial Group

TD Economics

Commentary

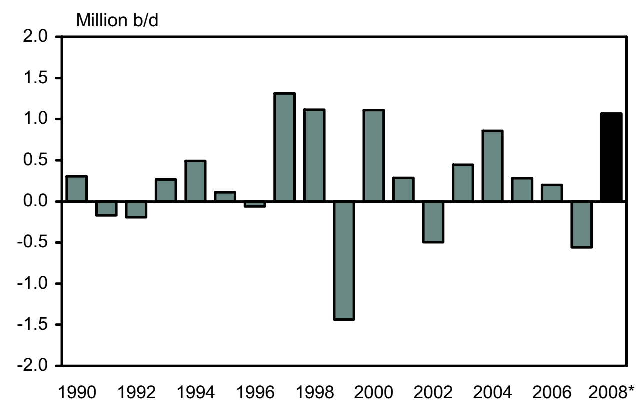
December 17, 2008

DESPITE OPEC RESTRAINT, OIL PRICE DOWNTREND TO REMAIN INTACT

- **OPEC slashes output quotas**
- **Supply surplus in 2009 still likely**

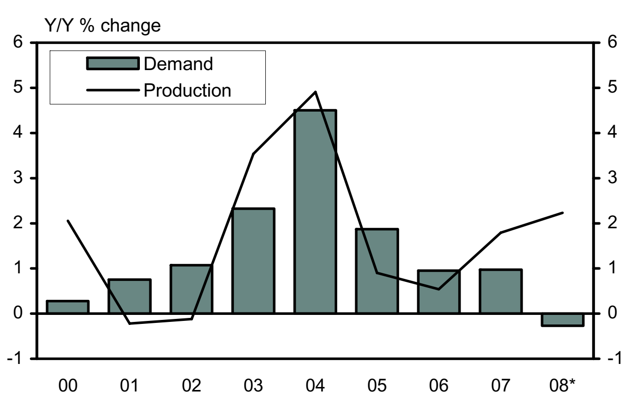
Today, at their 151st (Extraordinary) Meeting, OPEC decided to cut production quotas by 4.2 million barrels per day from September 2008 levels, effective January 1, 2009. Essentially, this works out to a 2.2 million barrel per day cut from current levels. While quotas have been slashed, compliance is another issue. The Saudi Arabian Oil Minister was quoted saying that the previous cut had a compliance rate of 85%. (The compliance rate drops to 65-70% if the 'unofficial' 500,000 barrel per day cut in September is factored in.) If quotas remain at the current level throughout the first quarter, OPEC production would fall 15% compared to the first quarter of 2008 *if* member countries fully adhere to the quotas. At an 85% compliance rate, OPEC output would be down 12%; a 70% compliance rate would push production down by 10%.

WORLD SUPPLY-DEMAND BALANCE



*2008 YTD: Jan - Nov data
Source: Energy Intelligence Group

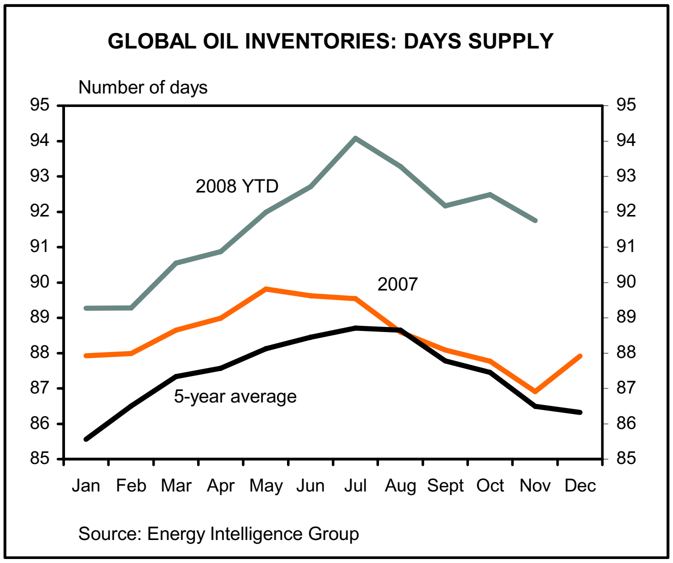
GLOBAL CONSUMPTION GROWTH VS PRODUCTION GROWTH



*2008 YTD: Jan - Nov
Source: Energy Intelligence Group

Despite this cut in output, the decline in demand has been, and will likely continue to be even greater, leaving the market in a position of excess supply. Including November's data, year-to-date global demand has slipped into negative territory at -0.3%. Supply growth for the same period is up 2.2%. As a result, the supply-demand balance is sitting at an average of 1.1 million barrels per day through the first 11 months of the year. And we expect to see a supply surplus hold in the 1-1.5 million barrel per day range in 2009.

What's more, global inventories, measured in days supply, remain well above their 5-year average (+5.3 days), and will continue to rise at least through the first half of 2009. Looking at the U.S., the inventory report released yesterday morning pointed to a 525,000 barrel build in crude



oil stocks in spite of a decrease in imports and domestic production. U.S. inventories are also sitting well above their 5-year average.

Prior to today's announcement, markets had priced in a 2 million barrel per day cut by OPEC. And after the announcement, prices slipped to a new 4½-year low of US$ 39.88 per barrel, as the U.S. inventory report stirred up fears that this cut will be insufficient to prevent a supply glut. While prices are already more than US$100 per barrel below the peak reached in July, we do expect crude oil prices to fall further by mid-2009 – to US$30 per barrel – as global economic conditions deteriorate further.

OPEC has its next meeting scheduled for March 15th, but if prices continue to plummet, they will likely meet earlier.

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