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OPEC Cuts vs. U.S. Shale Recovery

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On November 30, at their last meeting in Vienna, Austria, the Organization of Petroleum Exporting Countries (OPEC) and non-OPEC producers, led by Russia, agreed to extend oil production cuts until the end of 2018. In the last quarter of 2016, all 14 countries of the group agreed to cut oil production by approximately 1.2 million barrels per day, to 32.5 million barrels per day. This decision was the first time in eight years that OPEC committed to a curbing of production.

This most recent meeting extends this decision from an initial end date of March 2018 to December 2018, in an effort to rebalance the market since the pricing falls of 2014 and reduce excess oil inventories. OPEC, which was founded in 1960 with a goal of unifying petroleum prices of member countries and ensuring the stabilization of oil markets, produces about 40% of the world's crude oil, and its exports represent about 60% of oil traded globally. Due to its large market share, the group has historically had considerable power to control the oil market and pricing, but has seen that power to be waning due to the resurgence of U.S. shale production.

Oil prices have risen to over $60 per barrel from 2016 prices. The price increase has benefited U.S. oil producers and other non-OPEC producers. As prices have increased, the U.S. has taken advantage of higher prices to restart operations and supply the production that OPEC has cut back on. Per the International Energy Agency, "the U.S. Energy Information Administration (EIA) has released data showing that for September U.S crude oil output increased month-on-month by 290,000 barrels a day to reach 9.48 million barrels a day." EIA preliminary weekly data suggests that "U.S. production increased further into early December." According to EIA, "U.S drilling activity and well completion rates have picked up again, suggesting higher production to come in a few months. … Consequently, [EIA has] raised our annual growth forecast for total U.S. crude oil to 390,000 barrels a day this year and 870,000 barrels a day for 2018." The increase in U.S. and non-OPEC production acts as a barrier to OPEC's attempt to rebalance, as producers rush to cash in on the rising prices, creating more supply and adding to inventory reserves.

The OPEC decision is largely dependent on each country keeping its promise to cut back on production. As prices rise within the market, and U.S. and non-OPEC production increases, OPEC market share will continue to fall. OPEC countries and those who have agreed to the production cuts may be tempted to break their commitments, and take advantage of higher prices, which will in turn bring higher revenues, and a returned piece of market share.

OPEC plans to meet in June 2018, to assess the production cuts and construct an exit strategy, in hopes that the market will be rebalanced by the 2nd quarter of 2018. An exit strategy is necessary to have in place, to avoid a sudden spike in oil production. Whether a rebalanced market will be obtained is still uncertain, due to variables such as U.S. forecasted production, and member countries' commitments to the cuts. If the production cuts fail, and U.S and non-OPEC production continues to surge, there is risk of another price decline, as an excess of supply floods the market. For more information on OPEC's decision, contact us.

Sources:

https://www.cnbc.com/2017/12/14/us-shale-oil-leaves-opec-in-difficulty-iea.html

https://www.iea.org/oilmarketreport/omrpublic/

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