OPEC boosts oil markets with supply cut

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Failing to make an announcement on 6 December, the Organization of Petroleum Exporting Countries (OPEC) provided a positive surprise to the oil market on 7 December by announcing a larger-than-expected cut to production. OPEC and its non-OPEC partners (collectively known as OPEC+) will cut production by 1.2 million barrels per day compared to their October 2018 production levels. The market had expected around a 1 million barrels per day cut. While individual country quotas have not been reinstated, the exemption of Iran, Venezuela and Libya (where production levels are falling already) means that the burden of these cuts fall on other countries. So, OPEC is not simply hiding behind the supply declines that would arise anyway from these three countries. Indeed, if Iran, Venezuela and Libya continue to reduce production, total OPEC+ decline in production could be much higher than the 1.2 million barrels announced as part of the deal.

We had feared the lack of communication following the first day of meetings indicated that the group had not come to any agreement. We were also worried that Saudi Arabia could have bowed to US pressure and not pushed for a cut in production. Far from it. Saudi Arabia had led the core OPEC group to cut by 800 thousand barrels per day and OPEC's 10 partners said they will cut by 400 thousand barrels per day following the core group's lead. At the press conference Saudi Arabia was quite transparent in stating that it expects its production levels to decline from 11.2 million barrels per day to 10.2 million barrels per day by January 2019. That indicates that Saudi Arabia will be doing more than its fair-share to meet the group's goals.

What impressed us the most was that OPEC and its partners took steps to formalise their relationship. They were unable to do that back in June 2018, when it appeared that the group's cohesion was fraying. OPEC+ has thus made progress in strengthening its institution. Formalising the relationship is likely to keep the markets in balance for longer.

Oil prices initially rose close to 6% intraday on 7 December, but gains tailed-off to end the day just under 3% up. We believe that oil prices have further to gain as the agreement appears very positive in terms of bringing the market to balance.

Figure 1: Brent oil price

Source: Bloomberg, WisdomTree, data available as of 10 December 2018.

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