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Market Reacted to OPEC-plus Surprise Production Cut of 1.16 million bpd

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On April 2, the OPEC-plus group of oil-producing countries announced an additional production cut of 1.16 million barrels per day between May and December this year. The cut will be added to the current 2 million bpd production cut between November 2022 and December 2023. This is also in addition to a 0.5 million bpd production reduction between March and December this year that Russia announced to counter Western countries' introduction of a Russian oil price cap in February. Including the Russian cut, the total additional OPEC-plus production cuts come to 1.66 million bpd. However, an actual supply decline may be smaller than the production cut. There are some uncertainties regarding the additional production cut.

Leading the additional production cut are four Persian Gulf members of the Organization of the Petroleum Exporting Countries that cover more than 80% of the cut. Saudi Arabia accounts for 0.5 million bpd of the additional production cut, Iraq for 0.211 million bpd, the United Arab Emirates for 0.144 million bpd and Kuwait for 0.128 million bpd. The other participants in the additional production cut are Kazakhstan, Algeria, Oman and Gabon.

The additional production cut news came as a surprise to the international oil market, pushing up crude oil futures prices. On April 3, the front-month futures contract on West Texas Intermediate crude closed at $80.42 per barrel, scoring a $4.75/bbl (6.3%) rise from the previous day, the largest single-day hike in more than one year. The WTI futures price soared above $80/bbl for the first time since February 13. The key Brent futures price also soared sharply, gaining $5.16/bbl to $84.93/bbl. Until April 5, crude oil futures prices stayed above $80/bbl.

Since last year, crude oil prices have wildly fluctuated. In response to Russia's invasion of Ukraine and the announcement of a Russian energy embargo by the United States (followed by UK and Canada), crude oil prices briefly shot up above $130/bbl for the first time since the global financial crisis. Later in the first half of 2022, crude oil prices remained high above $100/bbl. In the second half of 2022, however, crude oil prices declined gradually on concern about global economic deceleration. Applying a brake to the decline was the OPEC-plus announcement in October 2022 to reduce production by 2 million bpd. Since then, crude oil prices had stayed within a narrow range of $70-90/bbl until mid-March because the OPEC-plus production cut as supporting factor for oil prices countered global economic deceleration as downside pressure.

The first key factor that exerted influence on the market trend was a market forecast regarding China's economic recovery. The forecast that China will start an economic pickup from the second half of 2023 following the termination of the zero-COVID policy late last year led the market to predict higher crude oil prices for the second half of this year. On the other hand, financial instability loomed as a major turbulent factor resulting from the failure of U.S. and European banks in mid-March. As noted in "A Japanese Perspective on the International Energy Landscape (628)," the growing financial instability induced risk-off sentiment and a looser supply-demand balance, exerting downside pressure on crude oil prices. The key WTI futures price slipped below $70/bbl briefly then. Later, however, the market restored stability thanks to financial authorities' initiatives to stabilize financial markets, encouraging crude oil prices to rise back above $70/bbl. However, recent market trends indicate that financial instability has not disappeared but has remained a matter of concern to the market.

In such a situation, the OPEC-plus announcement came as a surprise to most market participants. At a time when crude oil prices gained upside momentum due to disruptions to oil supply in the Kurdish region, the surprise OPEC-plus production cut announcement pushed crude oil price up sharply, as noted above. The group at a meeting of the Joint Ministerial Monitoring Committee last February reaffirmed the retainment of the 2 million bpd production cut. Recently, a major OPEC-plus group minister indicated the retainment. When crude oil prices were rising close to $80/bbl, however, the group announced the substantial additional production cut covering the second half of this year that was expected to see a tighter supply-demand balance, surprising market players.

In fact, however, the OPEC-plus announcement was not necessarily a surprise to me. As noted in my report cited above, I thought that the OPEC-plus group would take a quick action as necessary. Actually, the group decided to cut production based on its own logic and market analysis. The OPEC-plus group positioned the latest additional production cut as a precautionary measure. In response to the possibility of global greater economic deceleration amid financial instability and uncertainties about global oil demand expansion in the second half of this year, the OPEC-plus group apparently chose the additional production cut as a precautionary measure.

In this sense, the latest decision to cut production, as well as the adoption of the 2 million bpd production reduction in October 2022, came for the purpose of stabilizing prices under the logic of the oil market. However, the problem is that Western oil-consuming countries, including the United States, criticize any production cut from a viewpoint that deviates from the pure logic of the oil market. In fact, the United States issued a critical comment on the OPEC-plus decision, describing the decision as "not advisable". Crude oil price hikes could enhance inflationary pressure on the U.S. economy. Gasoline price increases could affect the U.S. administration's political popularity. These points are problems for the United States and other major oil-consuming countries. Support for crude oil prices and price hikes may benefit the Russian economy. Because of such geopolitical concern, major Western countries are critical of the OPEC-plus decision.

"If the OPEC-plus group takes actions to apply a brake to crude oil price falls or push up these prices when the U.S. economy is decelerating, tensions may arise between the United States and the OPEC-plus group led by Saudi Arabia". I noted this point in my report cited above (written as of March 15). I think that the concern indicated in the earlier report is growing.

Whether the OPEC-plus decision should be analyzed based on the logic of the oil market or the political viewpoint is an extremely difficult issue. At least, however, the following point is clear. The OPEC-plus group moves proactively and preventively to defend crude oil prices. In this respect, a downside support line for crude oil prices has arisen and is rising gradually. Given great uncertainties about various environments that surround the international oil market and crude oil prices, no optimism can be warranted about future developments. Depending on how far the global economy would decelerate and how the U.S. economy, including the impact of the lingering financial instability, would be, downside pressure will be exerted on crude oil prices. On the other hand, it is extremely difficult to predict a Chinese economic trend. Whether oil demand would achieve a strong expansion close to 1 million bpd year on year or narrow its growth amid economic stagnation will exert great influence on crude oil prices. We must also watch uncertainties about Russian oil supply and the Middle East situation. We should pay attention to future crude oil prices.

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