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Vienna Group Oil Producers to Cut Production by 1.2 Million bpd from January

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On December 7, the Organization of the Petroleum Exporting Countries and some non-OPEC oil producing countries including Russia (the so-called Vienna Group oil producers) announced their agreement to cut their oil production by 1.2 million barrels per day – 0.8 million bpd for OPEC and 0.4 million bpd for non-OPEC oil producers – from October 2018 level for six months from January 2019. The announcement followed the 175th OPEC conference on December 6 and the fifth Joint Ministerial Meeting of OPEC and non-OPEC oil producing countries on December 7 in Vienna, reversing their June 2018 decision to effectively increase production only in six months.

Ahead of the meetings of oil producing countries, many oil market participants anticipated a decision to cut production. This was because prices plunged some 30% from their peaks in October to $62.56 per barrel for Brent and $52.89/bbl for West Texas Intermediate on December 5 just before the meetings. Brent rose above $80/bbl as growing geopolitical risks in the Middle East were coupled with a prediction that the supply-demand balance would be tightened on a substantial fall in Iranian crude oil exports under revived U.S. economic sanctions on Iran. Later, however, oil market participants' perception turned around. Oil inventories turned upward as a substantial increase in U.S. oil production was combined with a production expansion by OPEC and Russia, leading supply to exceed demand. The United States exempted some major importers of Iranian oil from the sanctions temporarily, allowing Iranian oil exports to be maintained for the immediate future. Furthermore, global economic risks grew on the escalation of the U.S.-China trade war. As a result of these developments, oversupply instead of undersupply became a matter of interest or concern to oil market participants.

Earlier, crude oil prices' weakening from the second half of 2014 was prolonged, inflicting hardship on oil producing countries that heavily depend on oil revenue for national economic management. In a bid to escape from the hardship, they agreed to jointly reduce oil production, making progress in eliminating oversupply. In the second half of 2017, crude oil prices put an end to their weakness. In 2018, they rose back above $70/bbl, relieving oil producing countries. However, recent rapid price drops and future supply and demand outlooks prompted oil producing countries to recognize that they should take measures against oversupply to stop oil prices' further decline.

In addition to such market pressure, OPEC and its leader Saudi Arabia were exposed to another pressure, which came from U.S. President Donald Trump's message against any production cut. For the United States, any excessively low oil price affects shale oil production, exerting a negative impact on the upstream oil and gas industry. From the viewpoint of the entire U.S. economy and domestic politics, however, lower gasoline prices are significant for American citizens. Oil producing countries' joint production cut to push up crude oil and gasoline prices would not be favorable for President Trump. This was because President Trump frequently sent a message against any OPEC production cut before the Vienna meetings.

Any message from the president of the United States, the superpower playing a key role in maintaining stability and security in the Middle East, is not insignificant to the leaders in the Middle East. Particularly for Saudi Arabia that has had a “special relationship” with the United States and been concerned about the so-called “Khashoggi scandal” that has attracted global attention and could invite harsh criticism against Riyadh, the message from President Trump, who is giving priority to maintaining his country’s relationship with the current Saudi regime, was significant. Ahead of the Vienna meetings, OPEC and its leader Saudi Arabia were sandwiched between the market pressure and the Trump message.

As noted above, however, OPEC and other oil producing countries agreed to cut oil production by 1.2 million bpd from January 2019. In this sense, they succumbed to the market pressure. At the December 6 OPEC meeting, however, only a tentative production cut agreement came without any cut being specified. Market participants took such accord as vague and a sign of weaker oil prices, prompting crude oil futures prices to close lower on the day.

On the next day, however, OPEC and non-OPEC oil producing countries announced the more specific agreement to reduce oil production by 1.2 million bpd, leading the key futures price to rise by $1.61/bbl to $61.67/bbl for Brent and by $1.12/bbl to $52.61/bbl for WTI. Unlike the previous day’s vague tentative agreement, the broader accord on December 7 clarified the cut of 1.2 million bpd that was greater than the range of 0.8-1.0 million bpd as forecast by some market participants, contributing to crude oil prices’ rebound. These oil producing countries successfully averted the worst development in which they would have failed to reach any production cut or forged a vague agreement, inviting crude oil prices to plunge further.

While the worst development has been averted for the immediate future, however, two questions are still left pending for the future – (1) whether the agreement to reduce production by 1.2 million bpd would be fully implemented and (2) whether the production cut would be enough to push up crude oil prices. Regarding the first question, Russia, the largest crude oil producer among the non-OPEC countries participating in the production cut agreement, has been steadily increasing production and is expected to raise production further. In this sense, the extent to which Russia would cut production would attract attention. On the other hand, Qatar seceded from OPEC in January, with Iran, Libya and Nigeria left outside the joint production cut. Any actual production cut, including the extent to which OPEC leader Saudi Arabia would cover these countries’ share of the production cut, is still left uncertain.

The second question is also important. Many predictions say that the production cut of 1.2 million bpd would still leave supply to exceed demand in 2019. As a matter of course, any answer to this question depends on various uncertain factors such as global economic trends including the oil demand trend, the tempo of U.S. shale oil production expansion, Iranian crude oil exports after a 180-day waiver on the imposition of the Iran oil sanctions, and geopolitical risks. At present, the answer is difficult to make.

Reflecting these questions, crude oil prices’ rally after the announcement of the oil production cut agreement was not so strong. For example, Brent rose to an intraday high of $63.73/bbl on December 7 before falling back to $61.67/bbl at the end of the day’s session. As market participants fully consider the production cut agreement and try to find its impact on the market, downward pressure may arise again depending on the supply-demand balance.

In consideration of such uncertainties, OPEC and non-OPEC oil producing countries set their next meeting for April rather than the usually selected month of June. They apparently intended to clarify the need to reexamine market trends when the waiver on the Iran oil sanctions ends around this timing. The future courses of the international oil market and crude oil prices are still uncertain and should be carefully watched.

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