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OPEC-plus Group to Deepen Joint Production Cuts from January 2020

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On December 6, the Organization of the Petroleum Exporting Countries and some non-OPEC oil-producing countries including Russia held their ministerial meeting at OPEC headquarters in Vienna and decided to expand their joint production cuts by 0.5 million barrels per day from the current 1.2 million bpd to 1.7 million bpd from January 2020. The OPEC-plus group's production cuts are based on its Declaration of Cooperation released in December 2016. The ministerial OPEC-plus meeting was the seventh of its kind.

In a run-up to the meeting, oil market participants paid attention to whether the OPEC-plus group would maintain the current joint production cuts of 1.2 million bpd from the October 2018 level in view of the international oil market and crude oil prices from 2020 and whether and how it would enhance the production cuts. Eventually, the OPEC-plus group chose to expand the production cuts to 1.7 million bpd to support crude oil prices or exert upward pressure on them, as mentioned above. In addition, as specified in a press release for the meeting, some OPEC-plus group members including Saudi Arabia offered to further deepen their production cuts in a voluntary manner, leading to 2.1 million bpd in total production cuts.

Crude oil prices responded to the OPEC-plus decision to expand the joint production cuts and the voluntary cuts that were expected to substantially raise the overall production cuts. In London on December 6, the key Brent futures contract gained $1.00 per barrel to $64.39/bbl. In New York, the front-month West Texas Intermediate contract increased by $0.77/bbl to $59.20/bbl. For the first time in almost three months since September, Brent rose back above $64/bbl and WTI above $59/bbl. On the next trading day of December 9, they fell back slightly but remained above these respective levels. Some oil market participants predict that the enhanced production cuts would lead the supply-demand balance to further tighten from 2020.

The OPEC-plus decision to substantially expand the production cuts came as news to me. Just before the decision, my talks with stakeholders in oil producing countries led me to believe that while it would be necessary for the OPEC-plus group to deepen the production cuts from the viewpoint of the supply-demand balance, I was uncertain about such decision because of some factors to be checked. It was apparent that the supply-demand balance required the production cuts to be enhanced. This was because production in non-OPEC oil-producing countries such as the United States in 2020 was expected to expand by more than 2 million bpd against an increase of 1.2 million bpd in global oil demand estimated in line with a global economic growth rate of 3.4% forecast in the International Monetary Fund's world economic outlook.

Crude oil prices had remained capped by uncertainties about the future course of the U.S.-China trade war and lingering global economic slowdown risks. As noted in “A Japanese Perspective on the International Energy Landscape (454),” crude oil prices had been range-bound, though rising moderately. The key Brent futures price had failed to go beyond a $60-63/bbl range. Market participants might have been conscious of potential oversupply from 2020. Amid such market trend, speculation about a looser supply-demand balance next year, if growing, had been expected to exert downward pressure on oil prices before the turn of the year. The OPEC-plus decision to enhance the joint production cuts might have been designed to preemptively counter the potential downward pressure to support crude oil prices and create momentum for oil price hikes.

Most OPEC and other oil-producing countries structurally depend on oil revenues and are vulnerable to crude oil price falls leading to serious economic problems. Even though their oil production costs are at the world’s lowest levels, these countries are required to keep crude oil prices at very high levels to support their massive fiscal spending and keep a budget equilibrium. Current oil price levels are estimated to lead to budget deficits. In this sense, oil-producing countries are urgently required to support crude oil prices. Furthermore, OPEC leader Saudi Arabia, which took leadership in coordinating the enhanced joint production cuts, had a special reason for supporting crude oil prices ahead of its state-run Saudi Aramco’s initial public offering, as noted by some analysts.

Saudi Aramco’s IPO in Saudi Arabia is planned for December 11. On December 5, the oil kingdom announced an IPO price at 32 riyals per share, indicating an IPO size of $25.6 billion. Crude oil prices are undoubtedly the most important among factors influencing the IPO. In this sense, Saudi Arabia had apparently hoped to avoid any crude oil price decline and create momentum for oil price hikes. Not a small number of market participants believe that the Saudi hope was a factor behind the OPEC-plus decision to deepen the joint production cuts and some group members’ voluntary additional production reduction offers.

However, crude oil prices exert influence not only on oil-producing countries but also on the world economy and the international situation. Particularly, sharp crude oil price hikes could affect the U.S. social situation through gasoline price increases and would be a serious problem for the United States and its President Donald Trump ahead of the next presidential election in 2020. Every time when the OPEC-plus group decided to cut production, President Trump sent a Twitter message to check such decision.

Saudi Arabia views its relations with the United States, particularly President Trump, as important and gives sufficient consideration to the enhancement of the joint production cuts and the consequent oil price hikes. Given this point and Saudi Arabia’s role in coordinating the latest OPEC-plus decision, the need for supporting crude oil prices was very important for Saudi Arabia. Given its important relations with the United States and President Trump, Saudi Arabia may be required to adequately and flexibly implement policies and strategies while closely watching the future oil price trend.

The enhanced OPEC-plus joint production cuts would provide a new environment for the international oil market and crude oil prices in 2020. For the immediate future, crude oil prices will remain supported by the enhanced joint production cuts. However, we will have to pay attention to progress in the U.S.-China trade talks, the planned round of additional U.S. tariffs on Chinese imports on December 15 and its potential impact, the future course of the European economy, global economic slowdown risks and U.S. shale oil production expansion. The future course of the Middle East situation including Iran, geopolitical risks and potential oil supply disruptions will also be key factors worthy of attention. We will be required to keep close watch on the future international oil situation and oil prices.

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