Oil Market Report: November 2017

Cast your mind back to November 2014 and OPEC's annual summit in Vienna. At that meeting and despite glutted world oil markets, the cartel took the brave decision to maintain maximum output in an attempt to preserve market share for their oil. The impact of this decision on an already bearish oil market was devastating for OPEC Members, with prices immediately falling an incredible $6 / bbl on the back of the announcement. The crude price which had hitherto been at the $80 mark, went on to fall a further $35 over the next year. But even after that, at the same meeting 12 months later, OPEC once again voted to maintain maximum production levels and prices once again dropped off.

By November 2016 however and with no-end in sight to the low price environment, the will of OPEC was finally broken and the cartel gave up on their official policy of maintaining market share. Instead they announced the implementation of a Production Cap of 32.5m barrels per day (bpd) in an attempt to try and force oil prices back up. Now of course OPEC policy is not the only factor that drives prices up or down, but the fact remains that since the November 2016 announcement, prices have indeed risen from $45 / bbl to circa $63 / bbl at the time of writing this report. Which means in OPEC's eyes at least, the introduction of a Production Cap was the right decision to take.

Dominating OPEC policy are the Saudis and their allies (UAE, Kuwait). These Member States are typically viewed through western eyes as the "good guys" – basically benign (to the West at least) dictatorships that have demonstrated their willingness to prioritise sales of oil to Europe and America, above other regions of the world. More importantly is the fact that the Saudi "coalition" has by far the greatest levels of production and thus the greatest ability to practically influence OPEC strategy. Saudi Arabia alone produces a third (10m bpd) of the cartel's total production and is also the only member that has the ability to significantly increase production at short notice.

This overwhelming power continually puts the Saudis in conflict with other OPEC groupings – most notably, the smaller Iranian-Iraqi bloc. Not only do these two countries have very different relationships with the West, but in the bubbling cauldron that is Middle Eastern religion, they are both Shia countries who see themselves as consistently belittled on the OPEC Council by the dominant Sunni Members (Saudi et al). As a result of this perceived marginalisation, both Iran and Iraq have frequently ignored OPEC policy and have seen production cuts as "not their job, preferring instead to pass that burden back to Saudi Arabia. This stance has hardened in recent times, as both countries try to recover lost market share (Iran as a result of sanctions and Iraq through war) and much of OPEC's reputation as a body that says one thing but does another, is often blamed on these two nations.

So far, so Middle East and let's face it, OPEC is – in the end – mostly about the Middle East. But there are two further sub-groups to take into account. The first is the African Members and if it wasn't for chronic corruption in Nigeria and deep divisions between North and sub-Saharan Africa, then maybe these countries would wield greater influence. As it is, Algeria and Libya simply follow orders set by their Sunni brethren in the Middle East, whilst Nigeria's oil industry is so hopelessly inefficient (oil wells that work at 50% capacity, 10% of product simply burned off into the atmosphere as waste and a downstream sector that still has to import 90% of its refined fuel) that it only produces 1.7m bpd, even though it is permitted by the Production Cap to produce 2.2m bpd! The remaining African countries (Angola, Equatorial Guinea and Gabon) play little part in OPEC decision making, although socialist (but pro-market) Angola is seen as the continent's most efficient African Member state.

Efficiency is not a word often used for the final OPEC grouping of South America. This includes Ecuador, whose daily production is only equivalent to 25 seconds of world oil demand, so really this bloc begins and ends with Venezuela. Do remember that Venezuela is the oldest oil producing nation in the world and the possessor still, of the largest reserves (300bn barrels) found anywhere on the globe. But that's where the good news ends, for like Nigeria, the woes of this specific country could fill an article on its own (https://portland-fuel.co.uk/market-reports/2013/03/03/418/). Suffice to say, Venezuela has faced complete economic breakdown since oil prices fell in 2014 and is therefore desperate for prices to rise. But they still will not countenance any form of production cut whatsoever and such unwillingness to "play ball" is irritating to the OPEC Council. But irritation is about as far as it goes, because OPEC Members know that most Venezuelan oil is now no longer being priced into the market, because so much of it is being used in lieu of paying their debts.

In spite of all these differences, OPEC is still unified by one thing and that is a desire to see higher prices for their oil. In the last 3 years, this strange band of brothers have drained their petrodollar reserves in a desperate attempt to plug gaping financial deficits (even the mighty Saudi Arabia has had to "dip in" to its Sovereign Wealth Fund to the tune of $750bn) and whilst most OPEC Members hate the prospect of reducing production, they hate the prospect of lower oil prices even more. Which is why at yesterday's "Annual Ordinary Meeting" in Vienna, OPEC agreed to extend production cuts until the end of 2018…