



What's Next for Oil?

November 27, 2018

Key Takeaways

- ▶ From recent highs, crude oil fell to just over \$50 per barrel at the end of November.
- ▶ There is a risk that, without a 1.3–1.5 million barrels per day cut by OPEC, markets will be oversupplied next year.
- ▶ The upcoming G-20 Summit will likely include meetings between Russia and Saudi Arabia and between the U.S. and China that may drive oil supply and demand trends.

Oil prices are down. From recent highs north of \$75 per barrel, West Texas Intermediate crude fell to just over \$50 per barrel at the end of November, the lowest level in over a year. What is behind this drop and what is next for oil as December's OPEC meeting, U.S. policy toward Iran, demand trends and U.S. production take center stage?

Since President Trump announced in May that the U.S. is pulling out of the Iran nuclear deal, OPEC+ (OPEC along with other oil-producing nations including Russia) has added 1.65 million barrels of oil per day (bpd) to the market in anticipation of Iranian supply leaving the market. This has been supplemented by strong U.S. production growth. However, in November, the Trump administration announced that it will be issuing waivers on sanctions to a number of countries importing Iranian oil, in effect reducing the amount of Iranian supply leaving the market through sanctions.

At the same time, demand estimates have come under pressure due to macro concerns, including slowing Chinese growth and U.S.-China trade disputes.

The net result of increased production in the face of Iranian sanction waivers and expected lower global demand is a risk that without a 1.3–1.5 million bpd cut by OPEC, markets will be oversupplied next year.

Exhibit 1: Oil Supply Grows

Supply Changes (Average Million Barrels per Day)

	2Q18	Oct. 2018	Change
Saudi Arabia	10.1	10.7	0.6
Libya	0.9	1.1	0.2
Iraq	4.5	4.7	0.2
United Arab Emirates	2.9	3.2	0.3
Russia	11.4	11.8	0.4
U.S.	15.1	16.1	1.0
Iran	3.8	3.3	-0.5
Venezuela	1.4	1.3	-0.1
Total Supply Changes			2.1

Demand Changes (August to October)

	Aug. 2018	Oct. 2018	Change
2018 Estimate	99.2	99.2	0
2019 Estimate	100.7	100.6	0.1
Total Demand Changes			-0.1

As of October 31, 2018. Source: ClearBridge Investments, International Energy Agency.

OPEC+ has been discussing cuts of as much as 1.4 million bpd since the U.S. midterm elections. However, given Trump's pressure on Saudi Arabia to keep up production (thereby keeping oil prices down) and the ambiguous language from Russia on its potential cuts, the market is concerned that a large cut is not forthcoming at OPEC's December meeting.

G20 and OPEC Meetings May Be Telling

In connection with this, the upcoming G20 Summit in Argentina November 30–December 1 will be key for at least two major reasons. First, Trump is expected to meet with Chinese president Xi Jinping, and any major agreement on trade or lack thereof will have an impact on the demand outlook. Second, Saudi Crown Prince Mohammed bin Salman is expected to meet with Russian president Vladimir Putin; bin Salman is expected to try to secure Russia's commitment to oil production cuts ahead of the December 6–7 OPEC meeting in Vienna.

There is a good chance both the G20 and OPEC meetings will decide the fate of potential production cuts. The depth and duration of reductions, or the lack of cuts, will likely reveal a lot about the direction for oil prices in 2019. If the rumored reductions do not happen, oversupply may have to be cleared by oil prices falling low enough to force U.S. production declines and to stimulate higher demand growth.

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