

Global Economy / Energy and Commodities

# Will the OPEC succeed again?

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With the United States having abandoned the nuclear agreement with Iran, oil prices have rebounded amid expectations of a tightening supply. Paradoxically, the higher prices caused concern in the OPEC and amongst its partners. Whilst it is true that higher crude oil prices would lead to a windfall, it would also damage demand from their buyers, including India, China and the United States.

Consequently, on 22 June OPEC countries (led by Saudi Arabia) and their partners (led by Russia) agreed to raise crude production by 1 million barrels per day for the rest of the year, signalling a de facto termination of the pact to cut back on production that they signed at the end of 2016. The markets received the news with scepticism and, in defiance of expectations, oil prices have continued to rise. What explains this contradiction?

The answer lies in the markets' perception of the OPEC's – and especially Saudi Arabia's – ability to raise its production when faced with an unexpected fall in global supply in a context of sustained economic growth.

The OPEC's idle production is estimated at around 3 million barrels per day, 1.5 to 2 million of which are concentrated in Saudi Arabia. For the moment it seems that Saudi Arabia does have sufficient additional production leeway to compensate for a dip in Iranian exports and Venezuelan production. The risk is that, with production thus increased, the country may end up with a very tight margin for dealing with future circumstances. That is why the markets have reacted nervously to events such as the oil worker strike in Norway and the interruption in the flow of exports from Libya.

The situation is even more complex when one considers that, given the political cost of a sustained rise in petrol prices, the administration of President Trump has not hesitated to pressure Saudi Arabia into raising its production above the agreed quota whilst also pressuring other countries to completely end their purchases of Iranian oil.

Nevertheless, in a market as dynamic as the oil market it is always possible that the OPEC may not have to raise its production any further. That could happen if, for example, the trade war between the United States and China or the restoration of production in Libya shifted expectations towards lower oil prices.

In any case, the success of the OPEC's strategy is hanging by a thread... or, perhaps, a tweet.

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