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INTERNATIONAL

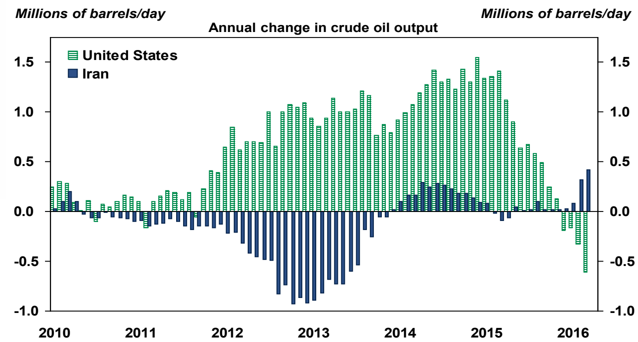
The oil market will keep rebalancing even though Doha failed

It looked like it was going to be a tough week for oil as the eagerly awaited meeting in Doha between Russia and several nations that belong to the Organization of the Petroleum Exporting Countries (OPEC) ended in resounding failure last Sunday. With Iran not there, Saudi Arabia finally refused to commit to freezing its oil production.

Contrary to what many feared, however, oil's negative reaction to the news of the failure was short-lived, and WTI (West Texas Intermediate) prices even jumped above US$44 a barrel this morning. In fact, an agreement among the countries at Doha would not have changed a thing for the world petroleum market. Neither Russia nor most OPEC nations seem to be in a position to boost their output over the coming quarters. In fact, production by OPEC nations excluding Iran has been topping out for several months now. Saudi Arabia is an exception, as it could theoretically increase its output by more than 1 mbd (million barrels a day), but nothing suggests it will decide to flood the market in the near term when the situation is finally starting to shift to its advantage. The news of an Iranian production freeze would have been very good for oil prices, but that was never a realistic scenario. Iranian oil output has gone up by about 0.4 mbd since the start of 2016, and can be expected to show another similar rise by year's end.

Another major oil producer—the United States—was not at Doha. In our opinion, what is now going on there is much more important for crude prices. The drop in drilling and energy sector investment has not only halted the spectacular surge in U.S. production, it is now triggering a large pullback. The Energy Information Administration estimates that crude production fell to 9 mbd in March, down more than 0.6 mbd from March 2015. Everything suggests the downtrend will persist until prices have come up substantially. Production by other countries is also being reined in by the low oil prices, though not as spectacularly. The International Energy Agency thus expect that non-OPEC production will drop 1.1 mbd from the fourth quarter of 2015 to the fourth quarter of 2016. This, combined with growth of about 1.3 mbd in oil demand, should almost wipe out the surplus in the global oil market, despite the expected increase in Iran's production.

U.S. oil production is down sharply



Sources: Bloomberg, Energy Information Administration and Desjardins, Economic Studies

Implications: The spectacular plunge taken by oil prices is having an increasingly obvious impact on the oil supply. U.S. oil production will continue to retreat, which should help balance supply and demand within a few quarters. High inventories could limit near-term gains, but WTI should end 2016 at around US$50 a barrel, then keep rising next year.

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