Supply Worries Send Oil Prices Up

Oil prices recently resumed an upward trend that brought the price of Brent oil to US$75 a barrel and the price of WTI (West Texas Intermediate) oil to above US$68. These are the highest prices seen since the end of 2014. One might wonder what is behind this increase when the dramatic surge in U.S. crude production signaled just recently a balanced global oil market and the price of WTI staying at around US$60 a barrel.

Basically, worries have surfaced about the Organization of the Petroleum Exporting Countries (OPEC) oil supply, which explains the recent rise in oil prices. The basic assumption of most analysts was that OPEC production would remain steady at around 32.5 mbd (million barrels per day) throughout 2018. However, the increasingly sharp drop in Venezuela’s production recently pulled OPEC’s production down to about 32 mbd. This downward movement could continue, as other OPEC countries, particularly Saudi Arabia, do not appear willing to offset this decline in production and welcome the upward pressure on oil prices. In this context, the global oil supply appears vulnerable to another supply shock, such as a conflict in the Middle East or new sanctions on Iranian oil exports.

IMPLICATIONS

The prospect of a slight deficit on the global oil market in the coming quarters and continued geopolitical tensions could help oil prices consolidate most of their recent gains. Therefore, we are now banking on the WTI price to remain close to US$65 a barrel in the coming quarters. In addition, the risk to this scenario is on the upside for the short term if new sanctions are imposed on Iran. In that regard, President Donald Trump has until May 12 to decide whether or not to drop the agreement that led to the rebound in Iran’s production.

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