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## WCU: Opec – to cut or not to cut, that is the question

Participants in the global crude oil market are eagerly awaiting the Opec meeting on November 27, the result of which could potentially set the tone and the direction of oil prices well into the first quarter of 2015. What's at stake is clear for everyone to see following what has been a game changing couple of quarters where the price of oil has slumped to levels not seen in years.

Rising supply both within and outside Opec has created this "new" situation where global consumers have gone quite quickly from worrying about supply disruptions and potential devastating price spikes to the current one where producers are suddenly competing on price in order to maintain market share.

New and unconventional production techniques such as shale oil extraction, among other things, have increased US oil output to the highest level in 30 years. Since 2011, this rapid rise in US production has been more than offset by rising global demand and constant supply disruptions due to numerous geopolitical events.



*Different member countries have different needs. Photo: Getty News*

The most important events during this time was the Libyan war in 2011, sanctions against Iran in 2012 followed by Libyan port strikes in 2013 and most recently, the emergence of IS militants in Syria and Iraq. During the first quarter of 2014, these major and other minor disruptions ran at the highest level since the Iraq/Kuwait war in 1991.

Since then Libyan oil has returned while some Opec members have seen rising production and others, most noticeably Saudi Arabia, have maintained a high level of production. The combination of rising supply at a time where demand growth has slowed has led us to the present situation where oil producers have experienced a sharp drop in revenues while oil-consuming nations, including China and the US – the world's two biggest, have received a major boost.

If Opec wants to do a quick fix it could agree on a sharp reduction in output until a balance between supply and demand has been re-established. Some of the weaker Opec nations such as Venezuela, Libya and Iran would probably prefer this route although they are not likely to contribute much to such a reduction themselves as they desperately need whatever revenue they can get. Wealthier producers such as Kuwait, UAE and Saudi Arabia are much more prepared to let the market determine what should be the new price range.

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*Some Opec countries, like Venezuela, Iraq and Libya, urgently need revenue. Photo: iStock*

The level of uncertainty about the outcome can be seen in the wide variety of expectations among analysts but also seasoned Opec watchers have said that this one is particularly hard to call.

Opec has several options of which the "do nothing" would hurt prices further as according to its own estimates it will only need to produce 28.4 million barrels per day during the first quarter. Current production levels are well above the cartel's present target of 30 million barrels per day.

Cutting production by significantly more than the 0.5 to 1 million barrels, which is currently expected, may help trigger a rally in the market and re-establish a range not too far below what was seen up until a few months ago. But in doing so Opec would indirectly support the ongoing surge in US shale production and within a year they could face a similar situation where prices once again come under renewed selling pressure.

US shale oil production require a relative high price to break even but continued innovation and improvements in production techniques during the past few years have cut this breakeven price for shale oil. It is therefore estimated that WTI crude will have to trade below 70 dollars for a considerable time before lower prices would begin to negatively impact production growth.

These developments both within Opec and outside brings us back to next Thursday's meeting and highlights why this could be one of the most important meetings in years. Thursday is by coincidence also the day where the US shuts down and families gather to give thanks for the blessing of the harvest and for the preceding year. This past year has yielded US farmers a record crop while consumers have seen the cost of gasoline fall back below 3 dollars per gallon, thereby raising consumer confidence and disposable income.

Will Opec go for a quick fix and worry about the future later or will it pass the challenge to US producers by allowing the price to remain low or go even lower in the near term? These are the questions that the market will be looking for answers to next Thursday.

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