



## Is the OPEC Agreement About to Send Oil to US\$60?

### Description

Recent news that OPEC has finally—for the first time since 2008—agreed to cut production has breathed new life into oil markets. WTI prices cleared the US\$48 mark for the first time since mid-August as sentiment in the market becomes more bullish.

This has led a number of analysts to give bullish near-term price forecasts. RBC commodities analyst Helima Croft sees oil moving to about US\$50 before year-end and continuing to trend up to the US\$60 level into 2017. **Goldman Sachs** sees the OPEC agreement (should it be strictly implemented) adding US\$7-10 per barrel to the price of oil. Goldman, however, quite tellingly, did not revise their price forecasts upward for 2016 or 2017 due to the uncertainty surrounding the deal.

For equity investors, the answer to what the OPEC agreement means for oil prices is important. If the most bullish forecasts are correct, investors should be adding exposure to oil equities with good leverage to oil prices immediately or risk missing out. There is good reason, however, for investors to continue being patient and waiting for pullbacks to add exposure.

### The market is responding bullishly to an incredibly uncertain agreement

The market seems to be reacting as if the OPEC agreement will be implemented exactly as advertised. In reality, however, the agreement is fraught with risk on several levels. Firstly, the actual effect of the OPEC agreement on the oil-market balance is likely to be minimal.

The agreement was advertised as a production cut with OPEC seeing a reduction of up to 796,000 bpd. OPEC sees August production of 33.2 million bpd being reduced to as little as 32.5 million bpd. The reality, however, is that a massive chunk of OPEC production growth (approximately 1.4 million bpd) is being exempted from the deal.

Starting with Libya and Nigeria, both these nations have seen huge reductions in their oil production levels due to violence. Libya has stated that it plans to triple its oil production in the short term, which would imply 608,000 bpd being added back to markets. Nigeria, on the other hand, is down 470,000 bpd from 2015 average levels, and if both these countries restore production, that is 1.078 million bpd being added to the markets. These means OPEC will not cut its production for August 2016 levels, but

actually increase it by about 282,000 bpd.

This doesn't even include Iran. Iran produced 3.6 million bpd in August 2016, but this is shy of the 4.1 million bpd that Iran's oil minister wants. This would take OPEC production up to 33.9 million bpd—above its 33.2 million bpd August 2016 levels.

Of course, many may say that the rest of OPEC cutting nearly 800,000 bpd from August 2016 levels would leave the market in much better shape than it would be without these cuts. It is important to note that August 2016 levels of 10.6 million bpd were record highs for Saudi Arabia (OPEC's largest producer).

Saudi Arabia boosted production by 400,000 bpd between May and August. Going forward, production was set to fall anyway due to seasonal factors—production typically falls by 300,000 or 400,000 bpd in the fall. According to **Bank of Nova Scotia**, Saudi Arabia would be frozen at 10.2 million bpd under the deal, which is higher than their 2014 and 2015 production and likely not much different than they would be producing anyway.

While a strict implementation of the deal would still be supportive since OPEC would not be able to increase production, OPEC has been historically very bad at sticking to and enforcing deals, outperforming previous quotas by 4.8% on average.

### **Investors can expect some near-term strength**

The news of the deal should support prices over the short term, but investors need to remember that the deal won't even come into effect until after November. In the meantime, news of higher prices will help support U.S. production growth, which could ultimately offset any benefit from OPEC at all.

Investors should continue to wait patiently to purchase names such as **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) on pullbacks. Baytex currently has the most leverage to oil-price increases, and the company has re-negotiated its debt covenants with banks to ensure there is virtually no chance of breaching them.

### **CATEGORY**

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1. Editor's Choice

### **TICKERS GLOBAL**

1. TSX:BTE (Baytex Energy Corp.)

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