OPEC Agrees to a Production Cut: Now What?

Description

It's a Christmas miracle! The Organization of Petroleum Exporting Countries has finally agreed to limit oil production to the 32.5 million barrel per day ceiling (down from 34 million barrels per day), which was negotiated earlier this year in Algeria. As per the latest reports, the final push towards an agreement came after Saudi Arabia conceded a special allowance for Iran to raise output to 3.8 million barrels per day from the previously proposed 3.7 million.

Furthermore, along with OPEC, non-member nations such as Russia have welcomed the decision and will join the cartel in limiting their own output by 300,000 barrels per day. The production cut, a first since 2008, means that $60/bbl (Brent) is finally within reach and removes any cloud of uncertainty over Canada's quality oil names.

Disaster avoided

What would have happened if the cut did not materialize? Simply put, sub-$40/bbl WTI would once again be a reality, and oil would have given up most, if not all, of the gains it has made in the last month due to production cut optimism. Without a cut, we would've expected OPEC production to average around 33-34 million barrels a day, which would be well north of the 32.5-million-barrels-a-day ceiling announced yesterday.

With global oil demand expected to slow going into Q1 2017, the International Energy Agency estimates a renewed OPEC price war would see a flood of supply in the market, rivaling 2016's crude surpluses of almost two million barrels per day.

All clear for Canadian names

The production cut bodes extremely well for Canadian oil names–more so than their American or European counterparts. This is because the geopolitical tone going into Vienna had notably shifted from prior negotiations due to the threat of the highly protectionist American president-elect set to take office next year.

Under the Trump administration, we might very well see a revocation of the Iranian Nuclear Agreement as well as tariffs on “terrorist supporting states” such as Saudi Arabia. If both these promises come to fruition, we could see Iranian output being curbed and a market share war between the OPEC nations as Saudi Arabia loses access to one of its most profitable customers.

And in both of these scenarios, Canadian oil names will profit as the shortfall in U.S. oil demand will be quickly picked up by renewed Canadian supply. Therefore, the “Miracle in Vienna” is ultimately a tremendous buying opportunity for Canadian names with strong balance sheets and cash flows, stable dividends, and production increases during the cyclical trough.

One such name that comes to mind is none other than **Suncor Energy Inc.** (TSX:SU)(NYSE:SU), which meets all of the above criteria and has a track record of counter-cyclical acquisitions, which will be now be paying off as oil prices finally rebound.

The bottom line

Christmas has come early for oil traders because OPEC has finally agreed to a production cut. Going into 2017, we can finally expect to see supply and demand re-balance–that is if OPEC member countries and Russia actually abide by the terms of the deal. For Canadian oil names, which were already trading at discount valuations before the OPEC meeting, this positive development just reinforces the bull case.

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Date
2025/07/02
Date Created
2016/12/01
Author

ajtun