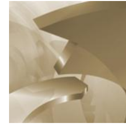

Economic and Market Insights

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Oil prices not likely to spike anytime soon despite Russia joining recent OPEC production cut

The worldwide dynamic that has kept oil inventories overflowing for the last two years may have shifted late last month when the Organization of Petroleum Exporting Countries (OPEC) agreed to cut cartel production to drive up prices.

Now that non-OPEC member Russia, the world's largest single-country oil producer, has publicly declared its support for either a freeze or a cut of its own petroleum production, higher oil prices could eventually return over the long haul.

But existing surplus oil inventories will delay worldwide impact until well into 2017.

Oil has been essentially loitering between $40 and $52 per barrel for the last several months. Petroleum companies are hopeful that their coordinated cut may allow them to punch through the current price ceiling toward the much higher "old normal," when the price per barrel was in an $80 to $100 pre-glut range.

Stock market observers have recently noted that when oil flirts with its higher price range, the equity markets as a whole seem to follow upwards. While there has been a correlation between rising oil prices and a rising stock market in the past, that relationship may have recently broken down some.

Oil prices have risen more than 14% after OPEC's announcement in Algiers that it would reduce supply.[1] U.S. markets, anecdotally, have been moderately volatile during this period, but confined to a trading range in the low 18,000s for the Dow Jones Industrial Average and 2120 to 2170 for the S&P 500.

So what can we expect in the coming months? In the past, Russia has waffled on its OPEC support. National output averaged a post-Soviet record of 11.1 million barrels a day in September as Russian investments in new fields are just beginning to gain traction.

OPEC, meanwhile, collectively pumps out about 33 million barrels of crude per day. The high volume output puts a lid on prices, and the $80 a barrel target that some analysts say is necessary for petroleum companies to make long-term plans is still a long way off.[2]

While the international drama continues to unfold, U.S. producers will be watching the upcoming national elections very carefully relative to domestic prospects for oil. Energy legislation could be a pivotal issue for some voters as lines are clearly drawn.

For example, if Democrats prevail in both the House of Representatives and Senate, more environmental protection legislation measures will likely be emphasized, possibly making it more of a challenge for energy and oil industry companies to get permits to build pipelines, update refineries, conduct exploration on federal lands, or work in anything not perceived as sustainable green energy sources. Oil frackers, in particular, may also be concerned as to what this will mean for their industry. On the other hand, wind and solar companies may see subsidies and tax breaks.[3]

If Republicans prevail, one can presume that the administration would be receptive to more drilling on federal lands, that pipeline-building restrictions would be relaxed, and that oil frackers would have more support for their industry.

OPEC meets again Nov. 30 in Vienna, Austria, where they will attempt to complete the agreement reached in September, and the U.S. election will have been decided by then. The outcome of these two very separate events could influence the future of oil prices for the immediate future.

Takeaways:

- Despite tightening of OPEC or Russian oil production targets, existing surplus oil inventories will delay worldwide impact until well into 2017.
- Depending upon the outcome of the U.S. elections, ensuing energy legislation could affect some oil companies.
- Contact your Commerce advisor to discuss this report in greater detail. If you don't have an advisor, please call The Commerce Trust Company at 1-855-295-7821.

1. Bloomberg
2. Bloomberg
3. Cornerstone Macro, Oct. 12, 2016

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