OPEC announces deal to cut oil production

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The OPEC oil cartel has reached an agreement to cut production in response to the halving of oil prices since 2014, the most significant downturn in the market in a generation.

The deal, finalised at the OPEC annual meeting in Vienna yesterday, came after two months of negotiations following an in-principle agreement reached in September to reduce output. The negotiations, which appeared several times to be on the brink of breaking up, were over the details of where the cuts in production would fall.

The talks were conducted under a degree of tension, amid warnings that if a deal were not reached then oil prices, which stabilised at $45 to $50 per barrel following the September agreement, would plummet, possibly to as low as $20 per barrel.

The main conflict in the negotiations was between Iran and Saudi Arabia. The Saudis demanded that Iran take a cut while the Iranians insisted they were still recovering from the sanctions imposed by the US, which had reduced production. Iran called on the Saudis to cut output as they had increased it after prices began to fall in 2014.

Under the agreement, OPEC, which supplies about one-third of the world's oil, will cut production by 1.2 million barrels per day (a reduction of around 4.5 percent) to about 32.5 million barrels for six months from the start of January. There is an option to extend the agreement until the end of 2017.

Saudi Arabia will bear the major portion of the cuts, reducing its production by half a million barrels per day, with Kuwait, Qatar and the United Arab Emirates agreeing to a reduction of 300,000 barrels a day. Iran promised to freeze its output at 3.8 million barrels a day, close to its present level of production, while Iraq agreed to a reduction of 210,000 barrels per day. Libya and Nigeria were granted exemptions because of the political turmoil in both countries.

Russia, a major oil producer that is not an OPEC member, agreed to a tapered reduction of output by 300,000 barrels per day in the first half of 2017. However, it said its cutback was subject to OPEC adhering to the overall limit as well as to Russian Energy Minister Alexander Novak described as "maximum participation" by non-OPEC countries in the restrictions.

At this point, it is not clear from which oil-producing countries outside OPEC—including Azerbaijan, Mexico, Oman and Brazil—cuts will come.

The biggest single winner out of the agreement appears to be the US energy companies, particularly those involved in shale oil production.

When oil prices plummeted from their levels of $100 per barrel in 2014, at times reaching as low as $30 per barrel, the Saudi regime stepped up production. Its aim was to drive down prices, expecting this to force high-cost US shale oil producers out of the market.

The tactic appears to have failed. Crude oil production in the US (both from shale and more conventional methods) is down by 6 percent this year and a further decline is expected in 2017. But this decline has not been enough to boost prices to anywhere the level of $60 per barrel that the Saudi regime appears to be seeking. Despite the reductions, US output is still above the levels reached in 2014.

On Wall Street, the S&P 500 oil and gas exploration production index, which mainly comprises US shale companies, was up by 10.8 percent in response to the OPEC announcement. Energy stocks as a whole rose by 5.6 percent, following a rise of around 8 percent in oil prices.

Whether this is maintained is yet to be seen. Michel Cohen, an analyst at Barclays Bank, told the *Financial Times* the outcome was consistent with what OPEC production levels had been expected to be in 2017 in any case. The OPEC agreement, he said, was "highly

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unlikely to affect the oil market balance."

Others pointed to the fact that the deal is contingent on an agreement with non-OPEC producers to reduce production and cast doubts on whether the cartel can shift prices as it did in the past.

The main factor in the Saudi promotion of the agreement is the impact of falling oil prices on its financial position and fears this could lead to political instability.

Summing up the overall position of oil-producing countries last April, the International Monetary Fund said the adjustment in government spending and taxation needed to absorb the oil price shock was "unprecedented." It said export revenues of oil exporting countries in 2015 fell by $390 billion, equivalent to 17.5 percent of their total gross domestic product.

The reduction in revenue has had major effects in Saudi Arabia, with billion-dollar government projects put on hold or cancelled and payments to major construction firms, medical establishments and foreign consultants delayed. According to a Reuters report, the amount still owing to construction firms alone is $21 billion. Companies were faced with delays of up to six months on work they had completed, as the government sought to retain cash.

Earlier this year, the ascendancy of deputy crown price Mohammed bin Salman to a leading position within the regime, second only to King Salman, and his plan for economic restructuring and diversification, was hailed as a major boost. His economic agenda was accompanied by a drive to push back Iranian influence as he launched a brutal air bombing campaign directed against Iranian-supported forces in the Yemen.

But the position of the Saudi economy has gone from bad to worse. The government's austerity drive—including delays in payments and cuts to public sector workers' benefits—has pushed the non-oil sector of the economy into a near-recession. It grew by only 0.7 percent in the second quarter of 2016 compared to 3.5 percent for the corresponding period in 2015.

The crown prince's Vision 2030 program is now widely regarded as a joke and wealthy Saudis have been moving billions of dollars out of the country.

One fund manager told the *Financial Times*: "The honeymoon is indeed over. There has not been one bit of good news for the government—from the economy to the disaster in Yemen."

Facing global economic stagnation—the driving force behind the oil price slump—and the boost that other energy sources may receive in the US from the incoming Trump administration, the OPEC agreement has an air of desperation.

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