**Alex Fusté**
*Chief Global Economist*
*Andbank*
alex.fuste@andbank.com
@AlexfusteAlex

# *2024 Energy Dynamics: Unveiling the Market's Keystone*

Last Thursday, November 30th, OPEC+ nations concurred to once again implement a voluntary cut in oil production. Following a long series of prior cuts, this last decision entailed a new and noteworthy reduction of 2.2 million barrels per day scheduled for the first quarter of 2024. To grasp the magnitude of the effort by OPEC+, the cumulative figure for voluntary output cuts since the group began reducing production would now stand at 3.66 million barrels per day. Saudi Arabia, the world's biggest exporter of crude oil, will lead again this last effort by extending a voluntary production cut of 1 million barrels per day. The kingdom's output will now stay at around 9 million barrels a day until the end of March 2024. In addition to Saudi Arabia, other voluntary barrel-per-day production cuts were announced: Russia by 500,000; Iraq by 223,000; the United Emirates by 163,000; Kuwait by 135,000; Kazakhstan by 82,000; Algeria by 51,000 and Oman by 42,000. This coalition of nations, spearheaded by Saudi Arabia and Russia, aims to deliver a financial punch to the West by driving up energy costs. The strategy is poised to stoke inflation, compelling Western central banks to maintain elevated interest rates precisely when the debt service bill is soaring. Adding to the momentum, Brazil, a significant player in the oil industry, declared its intention to join the alliance at the beginning of the upcoming year. Alexandre Silveira, Brazil's Minister of Mines and Energy, conveyed on Thursday that President Luiz Inacio Lula da Silva has given his seal of approval to the collaboration.

Despite the announcement of new OPEC+ cuts the market has sold down oil with a vengeance.

But what strongly catches my attention is that, despite this last announcement and the ongoing stranglehold on crude production by the OPEC+, coupled with significant ongoing international conflicts, the market has aggressively sold down oil with a vengeance. After the OPEC+ duly pledged to slash output again, Brent and WTI prices have now fallen 21% and nearly 24%, respectively, since their peaks in late September.

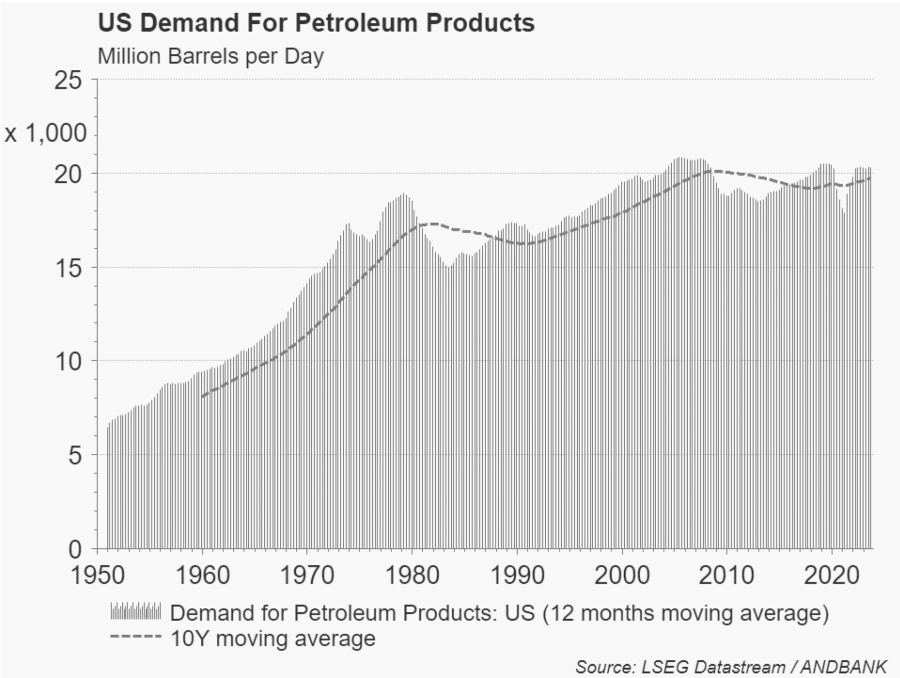
**The inevitable question then is: Why is oil crashing despite the OPEC+ efforts to boost its price?**

It is unnecessary to underscore that this relative calm in the energy market is allowing us to enjoy a strong performance in the global financial markets. Absent this stability in the energy sector, a surge in equity and bond prices most likely would not have unfolded. But regarding the significant drop in crude oil prices, more than the why, I'm interested in addressing the how.

Digging a bit I have observed that the sell-off in oil has been driven by heavier-than-usual futures trading. Between the end of September, when Brent hit US$97/bbl, and the end of November, the number of speculative short positions in oil futures more than doubled, meaning that more momentum players are jumping on the downward shift of oil price. Some reports describe heavy interest from trend-following CTAs (Commodity Trading Advisors involved in trading commodity futures contracts), and trading volumes in the ProShares UltraShort Bloomberg Crude Oil ETF are now running at around five times the levels seen in late April 2020, when a bear raid pushed oil futures into negative territory.

**Is this move justified by supposedly weak economic fundamentals?**
On the demand side, the bear move has been fueled by a narrative of slowing growth in the US and an economic crisis in China, both factors seen as drivers depressing oil demand. But whether this narrative is accurate or not is less clear. After hitting an annualized rate of 5.2% growth in the US GDP in 3Q23, economic data releases over recent weeks have shown no sign of an imminent slide into a recession in the US (see the last US labor report). Overall US demand for petroleum products is running well above its 10-year average (see the chart below) and to the extent that lower oil prices will weigh on inflation expectations, and soften the Federal Reserve's hawkish bias, the US growth outlook could even be said to be improving at the margin.

The sell-off in the oil price has been driven by heavier-than-usual futures trading.




If economic fundamentals fail to account for the decline in crude oil, then what explanatory factor motivates traders to sell oil and depress its price?

Similarly, discussions about a recession in China appear exaggerated. Admittedly, while the Chinese real estate sector grapples with significant challenges that impact prospects and local markets, the government is now implementing fiscal measures poised to support the achievement of a growth target ranging from 4.5% to 5% in 2024. Additionally, based on customs data, Chinese oil demand remains robust, with average imports increasing by 1.2 million barrels per day over the past 12 months.

On the supply side, US oil production is certainly booming, reaching a near-record level in the last week of November, but this recent recovery in production has only reached the levels seen in 1Q20 (just before COVID), which means that there has been no real expansion of production capacity. According to the Dallas Federal Reserve, investment plans in the exploration and production sector remain modest compared to 2022 levels. Therefore, reports that US crude exports are "flooding" the global market are inaccurate. According to the US government's Energy Information

Administration, US gross crude oil exports averaged 4.7 million bpd in November, below the 4.9 million in October and well below the 6 million suggested by some voices in the market. And although the US has become a net exporter of petroleum products (if we include refined products), in the last six months net exports have grown only about 300,000 bpd. A number that is insufficient to flood a world market of 100 million bpd. So, if the fundamentals, be it weakened demand from Western economies, or increased supply from the U.S., fail to account for the decline in crude oil, then what explanatory factor motivates traders to sell oil and depress its price? Can these factors endure over time, allowing us to continue enjoying affordable energy in 2024? The following explanatory factor come to mind: **An imminent collapse in the internal discipline of the members comprising OPEC+.**

The following explanatory factor come to mind: An imminent collapse in the internal discipline of the members comprising OPEC+

This scenario now seems plausible and may continue to exert downward pressure on oil prices, as it could lead to another war of overproduction to defend market share. I described this scenario as plausible based on the signals I am receiving. The recent OPEC+ meeting, originally scheduled for Monday, November 27, had to be rescheduled and pushed back by four days to Thursday. Market participants attributed the rescheduling to disagreements among members regarding the establishment of new production quotas. It seems that some cracks are starting to appear in the group, and these cracks could widen even more as the OPEC+ producers that are not subject to quotas (Iran and Venezuela) are placing their new production at the expense of other members subject to quotas. Some members are gaining the market share that other members lose. Logic leads me to believe that the group's members will refrain from breaking the internal discipline for the simple reason that the negative economic consequences of doing so would outweigh the current cost of gradually losing market share under the existing output system. That said, it must be acknowledged that maintaining group discipline becomes increasingly challenging during revenue crises. So, this is a scenario that I cannot and should not ignore. Specially if we understand that the fragility of group discipline is related to another development unfolding in the energy market which, in our opinion, may have continuity. A relief of sanctions against Venezuela or the relaxation of surveillance over the sanctions against Iran. Two decisions that are causing an effective increase in output by these two big producers, enabling Iran to currently produce close to 5 million barrels per day and allowing for a substantial increase in its exports (the majority directed towards China). A similar trend is anticipated with Venezuela's production. Together, these two producers have the potential to cause a significant increase in globally available crude oil. Another driver, albeit a more speculative one, could be linked to an unexpected emergence of peace talks regarding the conflict in Ukraine. Either because Kiev is compelled to do so, or because the financial toll of the war is weighing on Moscow's coffers and Russian society. Any development that brings us closer to peace would undoubtedly exert significant downward pressure on energy prices.

In any case. Commencing the year with a placid energy market lays the groundwork for a promising harvest. As a preliminary announcement, let me emphasize that I perceive a diminishing influence of OPEC+, the sole factor capable of driving up energy prices and unsettling the financial markets in 2024. In essence, this development is auspicious.