Written by **Bob Adelmann** on December 26, 2017

Crude Oil Price Outlook: Back to the '40s?

The same day that OPEC announced it would be extending its production cut agreement through the end of next year, the U.S. Energy Information Administration (EIA) announced that U.S. crude oil production jumped an astonishing 290,000 barrels per day from August levels.

Oil traders yawned and drove the price of crude higher. After all, it was a one-month spike, and compliance among both OPEC members and non-members remained surprisingly high. The agreement was taking crude oil off the market faster than producers were adding it. Voila! Increased demand coupled with decreased supply equals higher prices. Futures moved higher with Brent (prices set in London) moving past $62 a barrel with West Texas Intermediate (WTI, prices set in Cushing, Oklahoma) approaching $60.

Those traders were happy to ignore the increase in rig counts in the United States, and the more than 1,000 new horizontal wells being developed as a result — the highest seen since March 2015.

But all three official observers of the world's crude oil market had a surprise waiting: just before Christmas OPEC, the EIA and the International Energy Agency (IEA, located in Paris) each announced that those new wells, and new interest as a result of higher oil prices, will result in that September spike being no spike after all: they are predicting that the United States will add a million barrels of day of new production next year, almost a 10 percent increase over current levels. Put another way, just as OPEC and its friends are taking oil production off the market, the U.S. oil industry is adding it back.

It's a gift: OPEC gives and the U.S. oil industry taketh away.

It gets worse for OPEC. The IEA sees supply growing so rapidly that the magic moment of "balance" seems ever more distant. It says that, on a macro-economic scale, there will be 200,000 more barrels of oil being added to supply next year than will be absorbed by increasing world demand. This puts that elusive balance — where crude oil overhang comes down to its five-year average of three trillion barrels — ever farther out of reach.

There is at least one part of the equation missing from the seers' calculations: Venezuela. As its Marxist dictator Nicolas Maduro has destroyed his oil company's ability to produce, it has taken production of more than a million barrels a day off the market. But once Maduro is gone, new management isn't going to waste any time putting skilled technicians back to work, repairing and restoring PdVSA's ability to crank out its former 3-plus million barrels of oil a day.

Political considerations aside (and there are plenty), the economics continue to drive OPEC and its friends into relative impotency. Some of those political risks include further destruction of supply from Venezuela prior to Maduro's removal, increased attacks on Nigerian oil-producing facilities, disputes between the governments of Baghdad and Kurdistan, the re-imposition of sanctions on Iran, not to mention technical problems at any number of large oil-related facilities around the world.

But the economics of the equation will ultimately rule: OPEC cannot cut production by enough to offset American production increases. In its game, OPEC will continue to lose ground while American oil continues to gain it at OPEC's expense. That's why Harry Colvin, senior economist at Longview Economics, said he would "not be surprised" to see crude oil prices as low as $45 a barrel by next summer.

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