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Historic Coordination to Cut Oil Production

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Stocks were mixed on Monday. The Dow Jones Industrial Average and the S&P 500 fell while the Nasdaq Composite moved higher. The Dow Jones Industrial Average dropped 328 points or 1.39% while the S&P 500 index slid 28 points or 1.01% on concerns of what the coronavirus pandemic will do to corporate earnings. The Nasdaq Composite on the other hand closed higher by 38 points or 0.48%.

Over the weekend OPEC+ announced a record oil production cut, putting an end to the devastating, and ill-timed price war between the Saudis and Russians. These announced cuts are four times larger than the prior record cut executed in 2008. The official agreement by OPEC+ is that they will cut oil production by 9.7 million barrels per day – about 10% of normal oil demand. These cuts will begin in May and last for two months. After June, these curbs would be reduced to 7.6 million barrels per day until the end of the year, and then to 5.6 million per day until April 2022.

Additionally, Brazil, United States and Canada production declines, because of low prices, total 3.7 million barrels. Finally, other G20 oil producing nations not in OPEC+ are estimating an additional 1.2 million barrels reduction in oil output according to Barron's. However, these production cuts fall short of the estimated 19 million barrels of oil not being consumed per day due to the pandemic, according to Goldman Sachs.

The production cuts are unprecedented, and the coordination by various nations was also unprecedented. The original deal was defined last Friday but was not finalized due to Mexico's unwillingness to accept their proscribed production cuts. Mexico held a strong hand as they had hedged their production through wall street derivatives -- either way their production would be paid out at over $40 per barrel. The Mexicans held firm and ultimately, some arm-twisting diplomacy with other nations secured the agreement.

The price of West Texas Intermediate crude oil fell $0.26, or 1.1% as traders tried to understand the impact of the production cut. Further complicating investors analysis of the deal, Saudi Arabia's energy minister said on Monday that actions taken over the weekend would have the impact of a production cut of 19.5 million barrels per day taking into account the reduction pact agreed by OPEC+, the pledges by other oil producing countries and the pledged oil <u>purchases</u> by G20 countries to increase their respective strategic reserves. The minister announced that these oil reserve purchases were expected to be 200 million barrels over the next couple of months according to the IEA.

Oil has traditionally been a touchstone to the demand characteristics of the underlying economy. A Saudi/Russian price war in the face of precipitously falling demand exacerbated our economic crisis. Some coordinated effort was needed to restore some support to the oil market. However, the longer the worldwide economy is restricted the more these cuts will feel inadequate.