

OIL MARKETS

Oil Falls on Production Surge

Investors are concerned over rising output and falling compliance among OPEC members

By Neanda Salvaterra and Alison Sider

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Oil prices pulled back on Monday, weighed down by a strong dollar and data pointing to rising global production.

Prices have been on the rise, but gave up recent gains Monday as the rally ran out of steam.

U.S. crude futures fell \$1.09, or 2.11%, to \$50.58 a barrel on the New York Mercantile Exchange, their lowest settlement since Sept. 8. Brent, the global benchmark, fell 67 cents, or 1.18%, to \$56.12 a barrel on ICE Futures Europe.

“There were definitely naysayers on the rally. Clearly, you can point to some things” said Michael Hiley, a trader at LPS Futures, noting rising production figures. “People are responding to breaks out of a narrow range, piling on.”

Investors are growing concerned about a recent Reuters poll showing output among the Organization of the Petroleum Exporting Countries rose by 50,000 barrels a day in September as the cartel’s overall compliance with its supply-cut deal fell to 86%.

“It would definitely suggest there’s slippage in the agreement as far as adherence is concerned,” said Donald Morton, senior vice president at Herbert J. Sims & Co., who oversees an energy trading desk. Mr. Morton said the OPEC figures came as technical factors were already suggesting the market could be prone to a downward slide.

Several countries such as Saudi Arabia and Angola bore the brunt of the cuts while other countries such as United Arab Emirates, Ecuador and Iraq engaged in a bit of free riding, only complying by 30%, say analysts.

“Weak production discipline within OPEC and the cut exemptions for Libya and Nigeria should mean in our view that closely observed OECD stocks will not fall quite as quickly as expected,” said Commerzbank analysts in a recent report.

A resurgent dollar also took a toll. The Wall Street Journal Dollar Index, which tracks the dollar against a basket of other currencies, rose 0.42% to \$86.66 on Monday. As oil is priced in dollars, it becomes more expensive for holders of other currencies as the greenback strengthens.

“It is not surprising to see some investors taking the chips off the table especially given the stronger dollar and possible higher U.S. oil production going forward and definitely OPEC’s production increases as well,” said Eugen Weinberg, head of commodities research at Commerzbank.

Recently oil had been gaining based on newfound optimism about OPEC’s ongoing effort to rebalance the market and eliminate about 2% of global supply with the help of external producers such as Russia.

But the December contract for Brent is now trading \$3 below the two-year high it achieved last Monday when it hit its highest settlement since July 2015 and closed at \$59.02 a barrel.

Some analysts don’t foresee that recent political tensions and possible supply disruptions brought about by the independence vote in the Kurdish region of Iraq will be enough to offset the new stream of oil coming online.

And U.S. output is still on the rise. Drillers put more rigs to work last week for the first time in over a month.



A Glencore oil storage tank in Odessa, Ukraine. Oil prices had been gaining on newfound optimism about OPEC’s ongoing effort to rebalance the market. PHOTO: VINCENT MUNDY/BLOOMBERG NEWS

“At this point in time it would be rather odd to talk about disappointing shale production,” said analysts for JBC Energy in a recent note. “We are looking at implied annual production increases of somewhere between 600,000-900,000 b/d if the recent pace is sustained.”

Crude's recent rising fortunes were driven by speculation, as the number of net long bets placed by money managers on WTI rose by 52,000 contracts, or 25%, in the week ending Sept. 26, analysts said.

But oil prices might yet slip below the \$50 mark toward the end of the year as investors that were betting on prices rising in the future change their minds.

"Oil prices are therefore currently vulnerable to further profit-taking and price corrections," said Commerzbank analysts.

Gasoline futures fell 3.57 cents, or 2.24%, to \$1.5553 a gallon. Diesel futures fell 4.35 cents, or 2.4%, to \$1.7665 a gallon..

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