Trade Idea – Foreign Exchange
OPEC meeting offering false hope?
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Diplomatic attempts lift oil

- OPEC returned to centre stage last Tuesday as news of diplomatic efforts made by Saudi Arabia and Russia to implement a production agreement sparked a 5.7% rally in crude benchmarks. The upcoming OPEC meeting, scheduled for the 30th November, is highly anticipated as it could result in a coordinated production cut by the cartel (as agreed earlier in the year in Algiers) and is therefore a pivotal event in determining the future of both oil prices and associated currencies (CAD & NOK). Historically, OPEC members have been poor at keeping to production limits but on this particular occasion obstacles are even larger as many of the member nations are under considerable financial and political strain. Therefore, it is our view that risks to oil prices remain firmly skewed to the downside and it is increasingly likely that the USD/CAD and USD/NOK will continue on their current upward trend to the end of the year.

Deal or no deal

- The preliminary agreement at Algiers was for the oil cartel to reduce production to between 32.5 and 33 million barrels per day (mbpd), with Nigeria, Libya and Venezuela exempt from any arrangement. This would translate into a reduction of oil output of 0.6-1.1mbpd from October levels which, according to the International Energy Agency (IEA), would help balance the global oil market earlier than their current estimate of Q3 2017. In theory this is a very bullish prospect for oil prices but in practice imposing a coordinated production limit is complicated; particularly when the aim is to also coerce the likes of key non-OPEC oil producers like Russia to participate.

![Graph showing crude output, mbpd over time]

Figure 1: Potential exemptions may limit deal impact

Source: Bloomberg, ETF Securities

- Firstly, within OPEC, certain members have already started to show signs of foul play, either by demanding exemption or by inflating reported output figures with the hope of building a safety margin into any agreement. For instance, officials from Iraq have clearly stated that they do not intend to reduce production or participate in any agreement, citing their war on the Islamic State (ISIS) as sufficient reason for exemption. Also, in the latest monthly OPEC publication, the difference in reported output between secondary sources and direct sources totalled a positive 0.54mbpd for Iran and Iraq alone, a huge difference. For those nations that have been offered some form of formal exemption or are seeking it, namely Iraq, Nigeria and Libya, increases in

*All figures quoted are sourced from Bloomberg unless stated otherwise.

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production has been sharp in recent months (see Figure 1) which increases the burden on Saudi Arabia to curb output. Outside of OPEC group, the higher range of oil prices in the second half of this year has caused the number of active oil rigs in the US to increase by 40% since June and production has started to climb from an October low of 8.45mbpd. All these factors mean that curbing output meaningfully is going to be difficult for OPEC and so any deal that may emerge from the meeting could merely offer false hope. Potential market optimism that results and spurs a rally in oil prices and oil linked currencies is likely to be short lived and could be seen as an opportunity to establish short positions.

**Resistance to prove weak**

- Since the surprise Trump victory, the US Dollar has rallied strongly against the CAD and the NOK to trade at near short term resistance levels. The USD/CAD is retreating from 1.357, a 50% retracement level from the steep decline earlier in the year, while the USD/NOK is near the top of its recent 8-8.5 range. However, we feel as though both these pairs are on strong upward trends and a failure to reach an agreement in Vienna has potential to trigger moves to the upside beyond these resistance levels.

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