MARKETS

Global Glut Keeps Pressure on Oil Prices

Crude Producers Keep the Spigots Open Amid Lax Demand

By NICOLE FRIEDMAN

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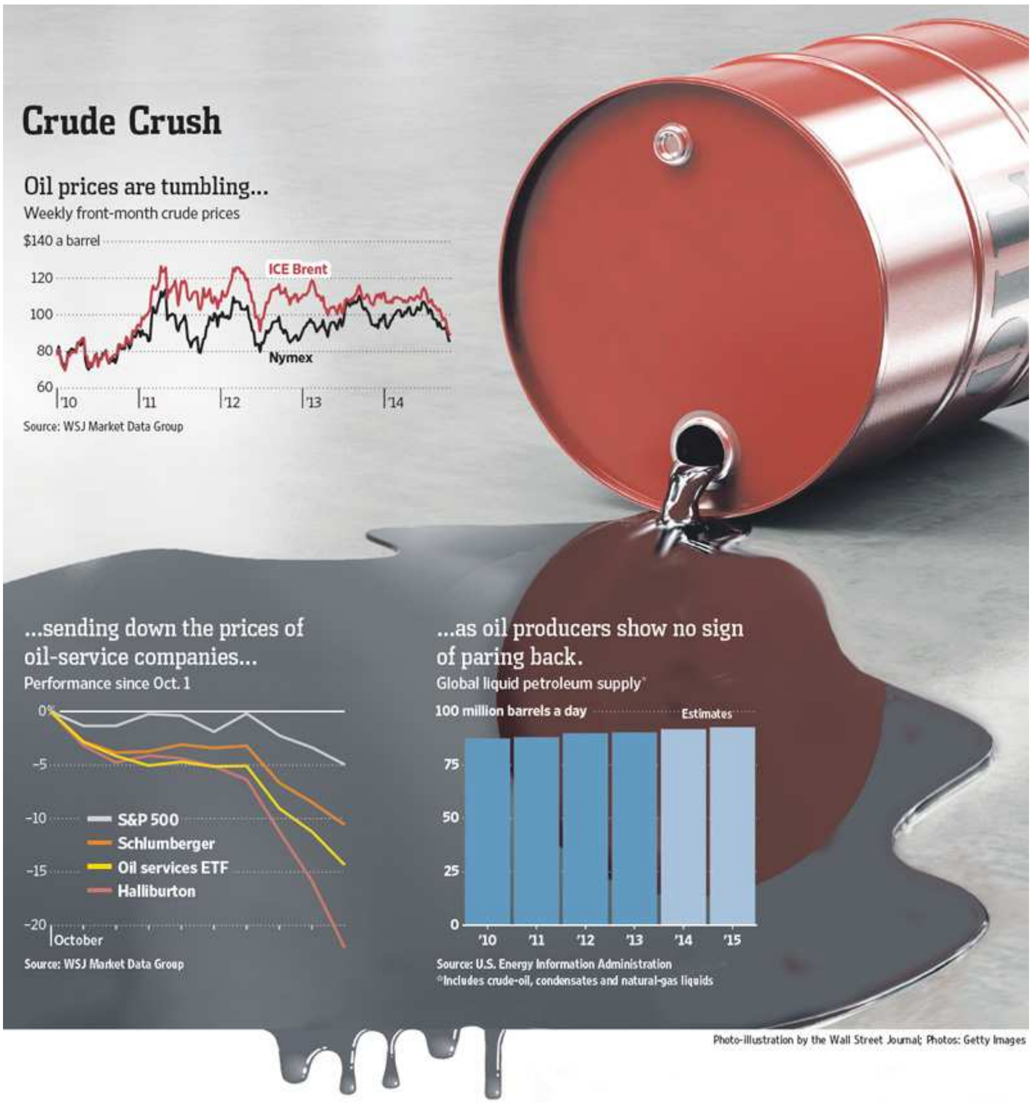


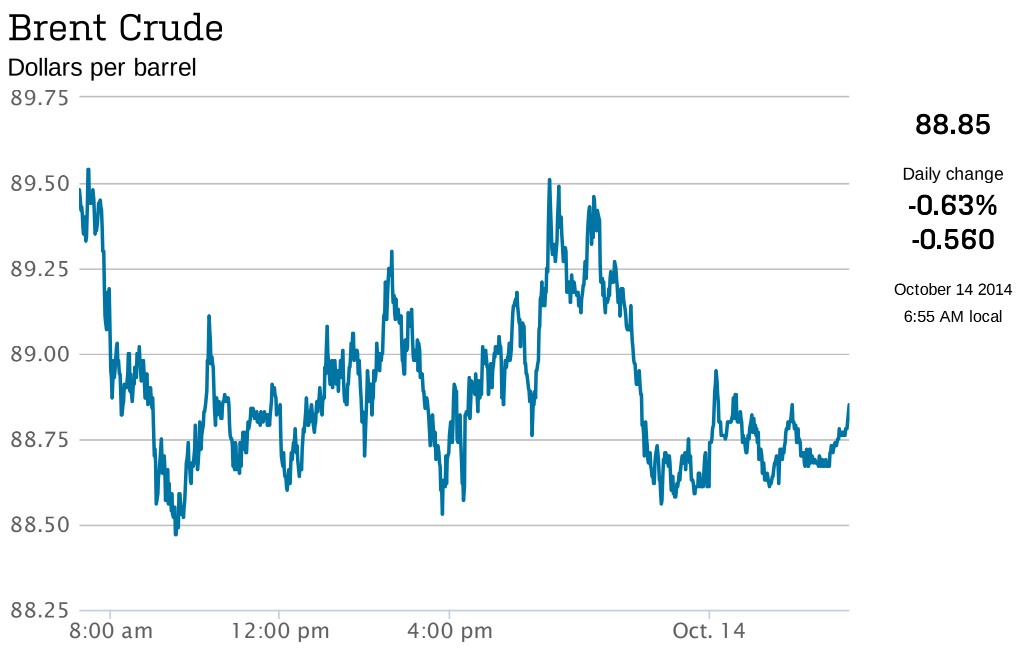
Getty Images

Traders are becoming increasingly convinced that the world will remain awash in oil.

Crude prices have tumbled more than 20% since mid-June. The global benchmark, Brent oil, dropped to a near-four-year low of $88.89 a barrel on Monday, and the U.S. benchmark dropped to $85.74, a 22-month low.

Instead of cutting back on output, to help reduce supplies and increase prices, oil producers—from U.S.

corporations to oil-rich nations—are keeping the spigots open. And there is little sign that global demand will rise quickly enough to help erase the glut.



Source: WSJ Market Data Group

Until recently, many investors expected that members of the Organization of the Petroleum Exporting Countries would collectively cut production. Such a move would quickly bring supply and demand back in line and likely spur a rebound in prices. But a rift within OPEC is making a reduction in oil exports look less likely at the group's meeting next month. That sets up the oil market for a slow grind lower, investors and analysts say.

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And within the U.S., companies also can remain profitable with prices at current levels.

Traders and analysts say that means oil prices could drop below $80 a barrel before producers in the U.S. and elsewhere feel enough pressure to ease back on output.

At current prices, "this is not going to lead to a decline in U.S. production," said Ed Morse, global head of commodities research at Citigroup Inc. Many OPEC members need higher oil prices to balance their budgets than U.S. producers need to keep drilling, he said. "It would be a tough struggle to say who is going to get hurt more, the U.S. oil producer or the OPEC oil producer, at a significantly lower price than today."

Investors have scrambled to adjust to falling oil prices, as they held record bets on price rises in June. Speculators, including hedge funds, have added more than 50,000 new bets that U.S. oil prices would fall and cut more than 100,000 bets on higher prices since mid-June, according to the Commodity Futures Trading Commission. In the Brent market, speculators have pulled back on wagers that prices would rise and more than doubled bets on lower prices.

Many investors remain focused on OPEC, which said Friday that its September production was the highest since the summer of 2013. In the U.S., crude-oil production hit a 28-year-high in September.

OPEC member Venezuela called over the weekend for an emergency meeting to respond to falling prices, but Kuwait said on Sunday that the cartel is unlikely to cut its production. On Sunday, Iraq became the latest OPEC member to lower its official oil prices. Saudi Arabia and Iran also have cut prices. OPEC's next meeting is Nov. 27.

Working at an oil field in Iraq's Kurdistan in August. Iraq on Sunday became the latest OPEC member to lower its prices. *Reuters*

If OPEC doesn't cut production in November, prices could fall in the next three to six months, said Alessandro Gelli, analyst at Diapason Commodities Management SA in Lausanne, Switzerland, which manages $5.5 billion.

"These past four years, the main balance in the oil market was Saudi Arabia," Mr. Gelli said. "They cut output alone these past four years, and now they want also the other OPEC members to intervene."

Diapason has wagered that oil prices will rise by the end of the year, in anticipation of higher demand as refineries finish seasonal maintenance and stronger global economic growth.

Mark Benigno, co-director of energy trading at INTL FCStone Inc., said lower demand and higher supplies will keep pressure on prices. "We'll probably keep trending lower for the next few weeks," he said. Mr. Benigno said prices would need to fall at least another $10 a barrel to force some U.S. shale producers to reduce output.

In addition to the OPEC meeting, traders are looking ahead to the Nov. 24 deadline for negotiations on Iran's nuclear program, Mr. Benigno said. Any agreement that allows Iran to export more oil could weigh on prices.

But some think oil prices don't have much further to fall, because the price is too close to the cost of drilling.

"If we get to the price point where it's not profitable to operate marginal wells, that's going to provide a bit of a price floor in terms of the oil market," said Keith Hembre, chief economist and portfolio manager at Nuveen Asset Management in Minneapolis, who oversees $800 million across four funds. His funds have less money allocated to commodities than is recommended by their benchmarks.

Mr. Hembre estimated that some shale-oil production could become unprofitable if U.S. prices fall below $80 a barrel. Others say prices would need to drop to $75 a barrel or lower.

Meanwhile on Monday, reformulated gasoline blendstock for November delivery, the front-month contract, fell 0.22 cent, or 0.1%, to $2.2553 a gallon, the lowest settlement since November 2010. November diesel fell 0.34 cent, or 0.1%, to $2.5568 a gallon.

—Sarah Kent, Benoît Faucon and Summer Said contributed to this article.

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