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# OPEC: LACK OF TRANSPARENCY LIKELY TO DRIVE OIL PRICE VOLATILITY

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Going into its meeting on Friday 22 June 2018, many of the Organization of the Petroleum Exporting Countries (OPEC) members talked a big game about production increases of close 1mn barrels per day. They left with no such commitment. The market had expected firm target production numbers and what they received was essentially a fudge – the product of a compromise to appease Iran – who had reportedly stormed out of a pre-discussion the night before. The non-OPEC/OPEC ministerial meeting on Saturday was equally vague. WTI oil price was up more than 6% up intraday on Friday before marginally retreating to 4.6%.

## One step back

The lack of transparency makes it very difficult to know what exactly OPEC intends to do. The stated objective is to get back to 100% compliance as a group instead of the over-compliance of 152% (OPEC calculation for the month of May 2018). But the deal that was agreed on in November 2016, assigned individual country targets and some countries were completely exempt (or could increase production). Now they appear to have a group-wide target for the OPEC-12 (excluding Libya, Nigeria and newly joined Congo). During the press conference, OPEC ministers were very evasive on the detail and only said that they aim to keep production for the group at 1.2mn barrels per day lower than the October 2016 reference point for a subset of the group. By my calculations that is an increase of 0.7mn barrels pre-day from today's levels, which is lower than what markets had been conditioned to expect.

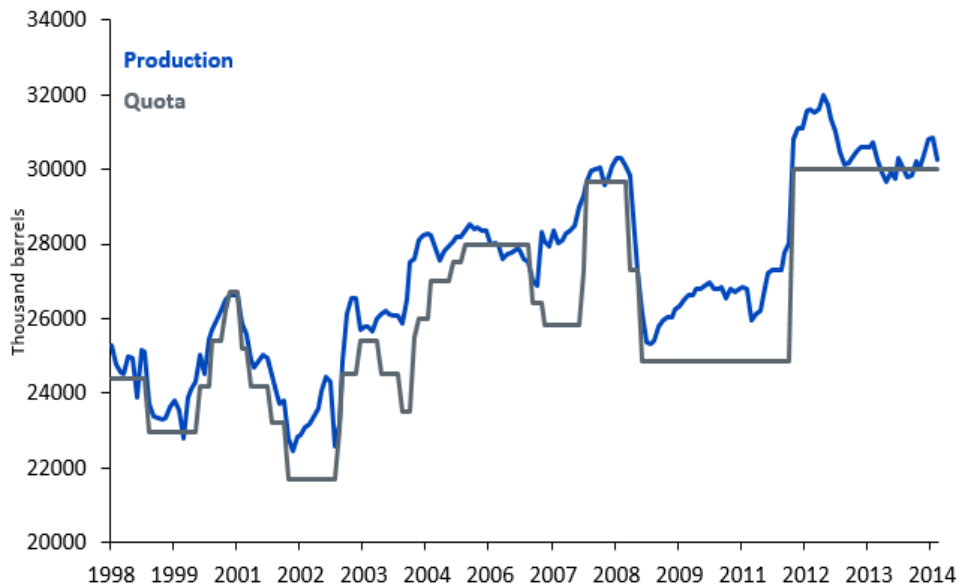
## A prisoner's dilemma – strong incentives to cheat

We believe the positive price reaction on Friday may have been premature. If history is a guide prices could easily fall fast. The poor framework lends itself to high price volatility.

Although the communication is obscure, we believe that OPEC has given the green light to those members who can increase production to go ahead and do so. Removing individual country quotas means that each individual nation is free to pump out what they wish – they are not violating a quota – only the group will be. The group could easily swing from over-compliance to under-compliance. Individual quotas had the benefit of transparency. A group-wide quota suffers from the classic problem game theorists call the “prisoners dilemma”, where betrayal is the equilibrium solution despite cooperation leading to everyone in the group being better off. Prior to 2014, when the OPEC only had

a group-wide quota, compliance was poor. Given that Saudi Arabia and Russia (non-OPEC member) were pushing for higher production levels, we think the new deal gives them room to manoeuvre. We expect oil production to rise, most likely removing Friday's price gains. OPEC's lack of transparency is likely to introduce a lot of volatility into oil prices.

Figure 1: OPEC adherence to quota pre-2014 was poor



Source: Bloomberg, wisdomTree, data available as of close 25 June 2018. Past performance is not indicative of future results.

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