Goldman Sachs' Warning Dents Crude Oil Price

The price of crude oil, which reached $65 a barrel a year ago, fell below $30 in January with expectations that its decline wouldn't end until it hit $20, or even lower. But hopeful optimists see light at the end of the tunnel — this coming from next Sunday's OPEC meeting in Doha, Qatar — where an agreement to freeze production at current levels will be on the table, to bid crude higher in an almost straight line. On Tuesday NYMEX crude hit $42 a barrel, a 40-percent jump from January's lows.

A note from Goldman Sachs on Tuesday provided a sobering view:

> The market has taken comfort in the production freeze discussion and the declining US rig count [but] we continue to believe that the balancing of the oil market is still far from secured.
>
> We see risks that even a production agreement [to freeze production of crude oil at current levels] could be followed by sequentially rising OPEC production given the multitude of potential sources [i.e., cheaters] of production growth….
>
> We see greater odds that the Doha meeting [will] deliver a bearish catalyst for oil prices … [and] we continue to believe that the balancing of the oil market [will require] sustained low prices with our [Q2 – second quarter] forecast of $35 a barrel.

In truth, the meeting in Doha is already fraught with dangers and increasingly likely disappointments. For one thing, Iran, one of the major OPEC players, isn't sending its oil minister, but instead a lower level bureaucrat as an observer. Iran has repeatedly insisted it will continue to pump crude as fast as possible to get its production, and its income, back to pre-sanction levels. Until then, any discussion of a freeze is out of the question.

Second, Saudi Arabia's oil minister, Ali al-Naimi, just told the *Al-Hayat* newspaper that any actual cut in production is out of the question: "Forget about this topic!" he told reporters at the paper.

Third, U.S. production continues at an astonishing pace, despite the precipitous drop in rig count. On Wednesday the Energy Information Administration (EIA) reported that total petroleum products — gasoline, propane, crude, and its blending components — averaged almost 20 million barrels per day over the last four weeks, up more than three percent from the same period a year ago.

In addition, U.S. crude oil inventories rose by 6.2 million barrels last week, adding to the record high of 536 million barrels already residing in tanks, seagoing tankers, and salt caverns converted to underground storage facilities. That's three times higher than analysts expected.

Alex Beard, head of worldwide oil operations for Glencore, the huge Swiss commodity trading company, echoed Goldman's view, speaking at a conference in Switzerland: "Even if you come up with some sort of political agreement for a freeze [in production], it doesn't actually change the dynamics of the oil markets…. I think there is a chance of disappointment and I can't see a huge positive surprise."

Neither can David Stockman, President Reagan's director of his Office of Management and Budget. But not because of any success, or failure, in Doha. Instead, he sees a coming implosion of China's economy, with the consequent drop in demand for commodities in general and energy in particular. After the dismantling of the Keynesian policies that have driven China ever since "Mr. Deng [China's general secretary of the Communist Party] discovered the printing press in the basement of the People's Bank of China," Stockman concluded that "China has become a credit-driven economic madhouse." That madhouse is rapidly shrinking, wrote Stockman, noting as evidence that "during the first two months of 2016, for example, China's export machine has buckled badly. Exports fell 25.4% in February year over year, following an 11.2% decline in January…. The crack-up phase of China's insane borrowing and building boom is surely at hand."

Add to this the fact that the International Monetary Fund (IMF) has cut its 2016 worldwide growth forecast for the fourth time in a year. Put together, all of these facts bode ill for the price of oil, regardless of what might happen, or not, in Doha on Sunday. The "rebalancing" of the oil market — when supply equals demand and prices stabilize — remains a long way off.

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*