Deeper cuts from OPEC+

OPEC+ surprised the market on Friday, with the group making deeper than expected cuts. In the immediate term, this is supportive for flat price, however we still see a surplus over the first half of 2020

What was agreed?

OPEC+ members on Friday agreed to deepen production cuts over the first quarter of 2020 by 500Mbbls/d, which takes total production cuts to 1.7MMbbls/d for the quarter. While these cuts alone are not overly constructive given the over compliance from OPEC+ that we've already seen, Saudi Arabia has said it will produce 400Mbbls/d below its quota level, which makes the cuts more meaningful. This would see Saudi Arabia producing around 9.7MMbbls/d in 1Q20 and compares to an average of around 9.8MMbbls/d so far in 2019. Stronger cuts from Saudi Arabia mean that OPEC+ will in fact be cutting by 2.1MMbbls/d.

Heading into the meeting, expectations were that we would see OPEC+ extend the deal through until at least mid-2020. However the group has kept the expiry date at the end of March. There is still plenty of uncertainty around the balance over 2020 and a lot of this is centred around how strong US production growth will actually be. There has been a slowdown in US drilling activity and this calls into question whether the EIA's supply growth estimate of 1MMbbls/d is achievable. Given the uncertainty around US output, OPEC+ would rather wait and see how this evolves over the quarter and then take action if needed- they want to avoid cutting unnecessarily. This will be a decision that the group will make in early March, which is when they meet again.

Is it enough?

There is no doubt that the decision from OPEC+ was constructive in the immediate term, with deeper than expected cuts. However, whilst these cuts will eat into a significant surplus over 1Q20, it still leaves the market in surplus of around 500Mbbls/d. Also, while OPEC+ has tackled a large part of the surplus in 1Q20, they have yet to address the surplus over the second quarter of the year. We do not believe this is an issue, given that this will be something OPEC+ is likely to discuss when the group meets in early March. Our balance sheet suggests that OPEC+ will not need to cut by similar levels to 1Q20, instead they can revert back to cuts of 1.2MMbbls/d, as we have seen over 2019.

What does this mean for price?

We believe that the action taken by OPEC+ will be enough to support prices, and continue to expect ICE Brent to average US$60/bbl over 1Q20. The upside risk to this view is if we see any significant supply disruptions. A meaningful US/China trade deal would also prove bullish for sentiment. The outlook for 2Q20 will be largely dependent on what OPEC+ decides in early March.

Author

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com