# Is the OPEC deal falling apart?

Falling OPEC compliance is a concern which should weigh on the market.

## Deeper cuts are unlikely

Strong crude oil imports from China, along with positive economic data from the country has offered some support to oil prices, but there are concerns that OPEC countries aren't complying with agreed production cuts.Falling compliance means the prospect of more reductions is unlikely. A 14% year-to-date fall in oil prices has put pressure on OPEC countries to increase output in order to try to maintain revenues. Recently Ecuador said they were unable to meet their commitment with production cuts for this very reason. Given that Ecuador is relatively small within OPEC, it may not seem that much of an issue.

*The risk is that we see other larger producers following suit.*

Next week, an OPEC compliance meeting is scheduled to take place in Russia, and it is likely that there will be increased market chatter about capping Libyan and Nigerian output. This could provide some short term bullish sentiment for the market.

## The numbers

OPEC reported the group's crude oil output increased by 394 thousand barrels a day, month-on-month, compared with 240Mbbls/d growth coming from exempt members (Libya, Nigeria and Iran), while the remaining c.154Mbbls/d came from other members. Iraq increased its oil production by 61Mbbls/d to a YTD high of 4.5MMbbls/d, while Saudi Arabia also raised production by 51Mbbls/d MoM to 9.95MMbbls/d. The growth in production has pushed compliance of the OPEC-11 to a six month low of 95% in June 2017; while if we take into consideration Libya and Nigeria, OPEC compliance falls to c.60% in June.

## Upstream oil investment is recovering

After falling 44% between 2014 and 2016, global upstream investment in oil & gas is estimated to increase by around 6% in 2017 according to the International Energy Agency (IEA). A 53% increase in US shale investment is expected, while Russia and the Middle East are likely to see a modest increase in upstream capital expenditure. Latin America and Africa are estimated to see declines of 4% and 9% respectively. A recovery in crude oil prices from the lows of 2016 (ICE Brent averaged US$53/bbl in 1H17 compared to US$41/bbl in 1H16) and improved cost efficiency has helped increase exploration investment. The number of US oil rigs has increased 140% since bottoming out at 316 in May 2016, highlighting increased investment.

## Strong Chinese oil imports

Chinese crude oil demand continues to grow at a strong pace. Imports grew 18% YoY to reach 8.8MMbbls/d in June 2017. While over the first six months of 2017, imports grew 15% YoY to average 8.6MMbbls/d, compared with the US where imports averaged 8.1MMbbls/d. Lower domestic oil production (falling 4% YoY) and strong refinery throughput (increasing 3.4% YoY) have helped to explain these stronger imports. However, the scale and pace of imports raise some concerns over how sustainable it is.

## US crude oil inventories fall

The US has seen nearly a 14MMbbls crude oil drawdown over the two weeks ending 7 July 2017 (nearly 1MMbbls/d of withdrawals), which has pushed total crude oil inventories down to 495MMbbls, the lowest stocks have been since January 2017. There's still a long way to go, however, as we're above the 491MMbbls seen at the same stage last year, and significantly higher than the 5 year average of 419MMbbls. So while there have been large stock declines over recent weeks, a lot still needs to be done in order to bring inventories more in line with average levels.