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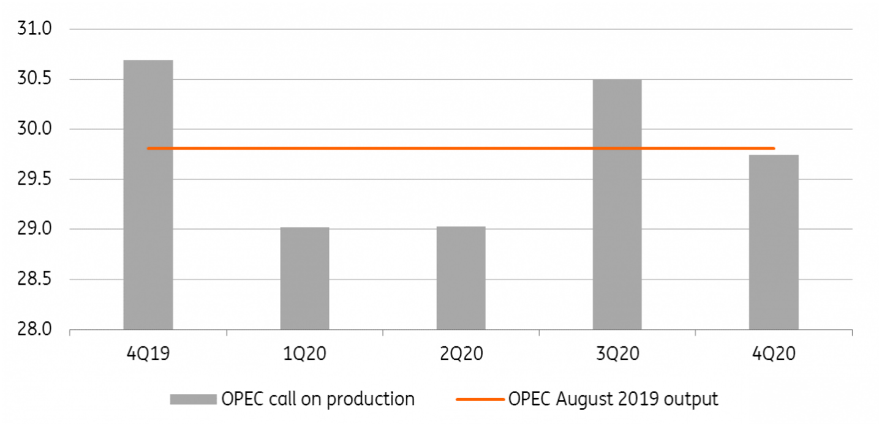
No relief for OPEC+ amid oil surplus concerns

Output at the Saudi Aramco oil facility devastated by a drone attack is now reported to be near normal and crude oil prices have retreated below US$60/bbl. The market now appears to be focused on two factors: the more pessimistic demand outlook and the heavy surplus expected in the first half of 2020

Journalists being shown the repairs to Aramco's oil processing plant after a drone attack

OPEC call on production



Source: ING, OPEC

It's a month since we saw ICE Brent shooting up 20% to trade at a high of US$71.95/bbl, following attacks on Saudi Aramco's oil processing facilities, which temporarily saw 5.7MMbbls/d of production taken offline. Therefore the latest OPEC monthly report was going to make for interesting reading and, in particular, how Saudi reported production would differ from secondary sources. It is no surprise that there was a significant discrepancy, with the Saudis reporting their production at 9.13MMbbls/d for the month of September, while secondary sources put output at 8.56MMbbls/d. And that's raising some questions as to the speed at which the Saudis have managed to restore production.

It appears the market is becoming increasingly complacent

Despite this, crude prices have made quite the retreat since the initial surge higher, with Saudi assurances of a speedy recovery enough to soothe market participants. However, with ICE Brent trading below US$60/bbl, one has to call into question the lack of risk premium priced into the market for any further future disruptions. It appears the market is becoming increasingly complacent, which is a fairly large upside risk, in the event of a supply shock. For now, the market appears to be focused on two factors- the more pessimistic demand outlook, and the heavy surplus expected over the first half of next year.

Firstly on demand, it is clear that demand growth has disappointed this year. We have seen consistent revisions lower, with the IEA revising down their 2019 demand growth forecast from 1.4MMbbls/d at the start of the year to just 1MMbbls/d in their latest monthly report released last week. Their outlook for 2020 has also been revised lower, with slowing GDP growth expected to weigh on oil demand growth. The longer trade talks between China and the US drag on without a comprehensive deal, the more likely that is to weigh on oil demand growth. The "mini deal" last week did provide a short term bounce for the market, but to move much higher it will want to see a final, comprehensive deal.

The other key obstacle for the oil market is the size of the surplus over 1H20; this is despite the current OPEC deal set to continue until the end of March 2020. The latest OPEC report puts the call on OPEC production in Q1 and Q2 at a little over 29MMbbls/d, which is above September's interrupted production of 28.49MMbbls/d but more importantly below August's output of 29.8MMbbls/d. This does suggest that OPEC+ will need to make deeper cuts in 1Q20, and extend the deal at least until the end of 2Q20 by as much as 1MMbbls/d.

OPEC's Secretary-General, Mohammed Barkindo, said last week that the OPEC+ group would do 'whatever it takes' to support oil prices amid the ongoing economic turbulence. We believe OPEC will be tested on this at their meeting in December. Failing to make deeper cuts can only mean a weaker price environment as we head into 2020.