OPEC+ cuts set to ease

The OPEC+ Joint Ministerial Monitoring Committee (JMMC) met yesterday, and as largely expected OPEC+ will start to ease production cuts from 1 August. Despite supply edging higher, the market will remain in deficit, allowing it to draw down inventories

How much will production cuts be eased?

As largely expected by the market, OPEC+ will start to ease production cuts from 1 August, which will see group cuts falling from 9.6MMbbls/d to 7.7MMbbls/d. If you factor in compensatory cuts from a handful of producers who fell short of the deal over May and June, theoretically the easing will not be as significant. Getting laggards to hit 100% compliance is hard enough, but forcing them to compensate for prior poor performance sounds virtually impossible.

But just assuming that laggards do deliver and compensate in full for their shortfall so far, actual cuts would be in the region of 8.1-8.3MMbbls/d for August.

The Saudis also stated that their oil exports in August would not exceed July levels, with additional supply to be consumed in the domestic market, and this is something which is expected for a number of member countries.

What does it mean for the market?

The easing in supply cuts is no surprise to the market, which had already largely priced this in. The outcome of yesterday's meeting does not, therefore, change our view. While demand may be taking longer than initially expected to recover, there is no doubt that we are still seeing a demand recovery and that this is a trend which is expected to continue in the months ahead. As a result, the global market should be able to easily absorb this additional supply from OPEC+.

We still expect that the global market will remain in deficit for the remainder of this year, and throughout 2021, which will allow it to continue drawing down hefty inventories. Therefore our outlook for the market remains intact. We continue to hold a more neutral view in the short term, with expectations that ICE Brent will average US$40/bbl over 3Q20, then as we move into the latter part of the year, and the market eats further into the inventory overhang, we see prices averaging US$50/bbl over 4Q20. Whilst for full-year 2021, with demand continuing to trend higher, and inventories lower, we expect ICE Brent to average US$58/bbl over the year.

What are the risks?

There are a number of risks to our view, with demand remaining key. While we have seen a resurgence of Covid-19 cases in some areas recently, we have not seen full lockdowns returning yet. However, clearly, if the situation deteriorates further, and we see a return of similar lockdowns to those earlier in the year, this will weigh on demand, and as a result, alter our outlook for the oil market.

Another risk, although more to our medium to long term view on the market, is if we see a swift recovery in US output. At the moment, we believe prices are still not at levels which will see producers increase drilling activity, but this could change if prices continue to trend significantly higher for the remainder of the year.

Finally, the more constructive outlook we hold for the market over 2021 assumes that the OPEC+ deal continues as originally agreed. If OPEC+ decide to ease cuts by more than originally agreed for that period, or walk away from the deal altogether, this would be enough to push the market back into surplus.

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