OPEC+ fails to come to a deal

The standoff between the UAE and the rest of OPEC+ continues, with Monday's meeting cancelled. In theory this means that OPEC+ output will remain unchanged in August, which would be bullish for prices in the short term. However, a breakdown in talks puts the broader deal at risk, and so the potential for supply to increase in the longer run

What's the issue?

The united front that we have seen from OPEC+ for a little over a year is clearly starting to strain, and with members still holding significant amounts of oil from the market there will be an element of frustration. Heading into Thursday's meeting, expectations were that OPEC+ would increase output by at least 500Mbbls/d in August. However, as the meeting got underway there were reports that the group had come to a preliminary agreement to increase output gradually by 2MMbbls/d between August and December. Spread evenly, this would equate to a monthly increase of 400Mbbls/d, so less than the market was expecting. This in itself would have been constructive for the market.

In addition to this, the Saudis wanted to extend the broader deal until the end of 2022, with it currently set to expire in April 2022. The reasoning behind this was concerns that the market would return to surplus when the deal expires in April. Once again, this would have been constructive, with it ensuring that OPEC+ continues to manage the market balance.

However, the UAE was not willing to accept an extension of the deal until the end of 2022, without an adjustment to its baseline. The baseline is used to calculate the level of cuts that each member should make. Under the agreement, October 2018 production levels were used for the baseline, and the UAE wants theirs increased from the current 3.2MMbbls/d to around 3.8MMbbls/d, which is closer to where they were producing prior to the current deal. But this would effectively mean that they could increase output substantially. The Saudis do not want to give in to this demand, given that it is likely several other members would also want their baselines adjusted higher.

With neither side willing to compromise, Monday's scheduled meeting was cancelled, and for now its not known when the next meeting will take place. As things stand, this means that in theory OPEC+ output levels will remain unchanged in August. However, in practice it is hard to believe that some members will stick to the deal amid the fallout.

Failing to come to a quick compromise would mean the beginning of the end of the broader OPEC+ deal. This is something that the group would want to avoid, particularly with last year's price war still fairly fresh in everyone's mind.

How badly does the market need additional supply?

The oil market has tightened considerably since last year, with OPEC+ doing a great job in rebalancing it. OECD oil inventories are back in line with the 2015-19 average, and inventories are set to continue falling with global oil demand recovering as we move through the rest of the year. By the end of this year, demand should be around 97% of pre-covid-19 levels. So, without increasing supply further over 3Q21, the market is likely to see inventories drawing down by around 2MMbbls/d, while over 4Q21, the drawdown would be more than 2MMbbls/d. Therefore, the market needs to see supply increasing over 2H21. Even if we do see some sort of resolution, and the group eventually agrees on a 400Mbbls/d supply increase per month from August through until the end of this year, the market will still be drawing down inventories, and so prices should still be relatively well supported.

What does this mean for the market?

The fallout within OPEC+ means increased uncertainty in the months ahead if a quick resolution is not found, which suggests increased volatility in prices.

With large inventory drawdowns expected whether output remains unchanged or increases by 400Mbbls/d per month, oil prices are likely to remain well supported in the near term. As a result, we have revised higher our short-term oil price forecasts. We now expect ICE Brent to average US$75/bbl over 3Q21, but clearly there is the risk of spikes higher, given the uncertainty at the moment. We have retained our view that Brent will average US$70/bbl over 4Q21. This is assuming that OPEC+ will eventually come to a deal. There will be growing pressure on OPEC+ from consumers to increase output. India has made it clear a number of times that they want the group to increase output, whilst the US government has asked OPEC+ to find a compromise, which will allow output to increase. In addition, we continue to hold the view that Iranian supply will make a comeback towards the end of this year, which should help relieve some of the tightness.

A scenario where we could see significantly weaker prices, is if the group fails to find a solution to the standoff. The longer it persists, the more likely that we start to see compliance slip, and the deal slowly fall apart. This would be a scenario that OPEC+ would want to avoid, given that there is still a large amount of uncertainty over the demand outlook.

ING oil price forecasts

Current	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22
ICE Brent (US$/bbl)	61	69	75	70	68	70	73	70
NYMEX WTI (US$/bbl)	58	66	73	68	65	67	70	67

Previous	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22
ICE Brent (US$/bbl)	61	67	70	70	68	70	73	70
NYMEX WTI (US$/bbl)	58	64	67	67	65	67	70	67

Source: ING Research

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