

OPEC meeting: Four things to watch

How markets could react to the four major issues to be worked out in Vienna on the 25th May



Source: iStock

Encore to an empty room

Five months into a 1.8 MMbbl/d production cut agreement, the OPEC and NOPEC band are getting back together this week to discuss an extension, but is the crowd still listening? The original deal initially supported markets but stubbornly high levels of inventories have depressed prices and concerns for the redux linger – Saudi Arabia can compensate for other members' non-compliance, but when the orchestra turns out to be a one man band, who isn't disappointed?

Bigger, better and even less believable

Like most attempts to outdo the original, this week's extension promises to both improve and expand – compliance from countries which were previously lagging (Iraq, Russia) will be corrected and new members will join the band (Egypt, Turkmenistan).

Realistically, we believe there are four major issues to be worked out in Vienna on the 25th, with

the market impact of possible outcomes drawn below

Possible market outcomes from the OPEC meeting

Length of extension	No Exemption	Nigeria, Iran, Libya Exempt	Nigeria, Libya, Iran, Iraqi Kurdish region exempt	Nigeria, Libya, Iran, Iraqi Kurdish region exempt, Russia leaves
0 Month	Bearish	Bearish	Bearish	Bearish
3 Months	Neutral	Bearish	Bearish	Bearish
6 months	Bullish	Neutral	Bearish	Bearish
9 months	Bullish	Neutral (most probable)	Neutral	Bearish

Source: ING

1) Nine months or six months to recover

While initial plans were to discuss a three-to-six month extension, the conversation now seems to be centred on a nine-month extension i.e. until March 2018. The extension is designed to dissipate the high levels of oil in storage - OECD petroleum inventories at the end of 1Q17 stood nearly 260MMbbls above the five year average. The IEA estimates a stock drawdown of c.0.7-1MMbbls/d for the duration of the OPEC deal, which would theoretically place inventories back at the five year average by the end of the nine-month extension. Anything shorter, or slower drawdown rates, spell price weakness

2) Allowed exemptions and the Iraqi wildcard.

The current deal saw Libya and Nigeria being exempt from cuts as domestic issues reduced output and both needed time to recover lost production. As the geopolitical position of both countries remains tense, both countries are likely to seek further exemptions, despite a significant recovery in Libyan production towards 700 Mbbls/d.

Iran has also been allowed to increase its oil production by 90Mbbls/d to 3.797MMbbls/d during the last deal; and the country has been largely adhering to the production limit since then. Iran also understands that oil prices above US\$50/bbl is crucial to attract the foreign investment into the oil exploration in the country; and hence likely to agree to the deal limiting its output near the same level of the last deal.

The wildcard for this topic is Iraq and specifically oil production and exports from semi-autonomous Kurdistan region. Iraq and Kurdistan follow independent oil production strategies while OPEC considers Kurdistan production as part of Iraqi supply. Hence, if Kurdistan doesn't comply with cuts targets, Iraq needs to compensate by cutting more than its fair share of targets. Kurdistan doesn't currently report production figures and could add nearly 50-60Mbbls/d of 'ghost production' this year: complying with Iraq's production cut, but flowing into the market nonetheless.

3) Discipline amongst strangers

On paper the original agreement has been oversubscribed - compliance increased to 109% in April 2017 (increasing from 103% in March 2017) with 5 of 10 OPEC countries including Qatar, Saudi Arabia, Kuwait, Venezuela and UAE cutting even more than targeted. Setting aside Venezuela's seemingly terminal decline, the question is how long these 'overcutters' will adhere to an agreement which others such as Iraq and, crucially, non-OPEC countries like Russia, are failing to meet. According to Reuters, non-OPEC members were only adhering to 64% of their agreed cuts

earlier this year.

109% OPEC compliance in April 2017

4) New friends or name dropping

The first production cut included eleven non-OPEC countries like Russia and Oman, but reports suggest new members may be joining. Turkmenistan and Egypt will be present during the Vienna discussion on 25 May, and while they are not considered heavyweights in global production, together producing 700 Mbbls/d of oil. We doubt either country will be willing to reduce production, and even if they agree to a cut of 5%, monitoring compliance to a 35 Mbbls/d cut in Egypt/Turkmenistan will be a difficult feat. All told, unless Canada decides to the party, we think the impact of additional countries is likely to be psychological rather than physical.