Article | 28 February 2020

OPEC+ meeting: Great expectations

OPEC+ are set to meet on 5 and 6 March. The market is expecting a lot from them given the demand impact from Covid-19. It is clear that OPEC+ needs to take action. However, the level of cuts needed is less clear

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Covid-19 & demand worries

The biggest worry for the oil market at the moment is the demand impact from the Covid-19 virus outbreak. The hit this is having on demand does mean that the expected surplus over 1H20 has grown, and therefore the need for even further action from OPEC+. As we mentioned recently, we are assuming that we will see demand growth slowing by around 400Mbbls/d over the year, and so leaving demand growth at just 800Mbbls/d for 2020.

However this is an evolving number, and there clearly is further downside to demand growth as we see an increase in the number of reported cases outside of China.

Why we have revised our price forecasts lower

OPEC+ performance

Back in December, OPEC+ agreed to additional cuts of 500Mbbls/d for 1Q20. This, along with continued over compliance from Saudi Arabia, takes effective cuts for the group to 2.1MMbbls/d over the quarter. OPEC performance with the deal over January was good, with output averaging 28.32MMbbls/d over the month, down 505Mbbls/d MoM. This fall was driven by the deeper cuts agreed, along with a plunge in supply from Libya, given the ongoing export blockade in the country. Libyan output has fallen from an average of 1.14MMbbls/d in December to around 120Mbbls/d currently.

When OPEC+ decided on deeper cuts in December, they failed to extend the deal through until the end of June, which still left a sizeable surplus in 2Q20. The group decided that it would review the market situation at the extraordinary meeting scheduled for next week, before agreeing to any action for the second quarter. However, the outbreak of Covoid-19 has meant that action from OPEC+ has become more pressing.

What do they need to agree on?

The OPEC+ joint technical committee (JTC) recommended to OPEC+ ministers to extend the current deal through until the end of this year, whilst deepening cuts by 600Mbbls/d over 2Q20. More recently, there have been media reports that Saudi Arabia is pushing for an additional 1MMbbls/d of cuts.

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We believe that deeper cuts of 600Mbbls/d over 2Q20 should be enough to keep the market largely balanced over the second quarter for now. However, there is also uncertainty over when Libyan supply will return to normal. If output in the country returns to normal fairly quickly we will probably need to see cuts closer to the 1MMbls/d that Saudi Arabia is reportedly pushing for.

As we have seen in the past, it is Russia who needs convincing when it comes to production cuts, and this time it is no different. Russia has been fairly quiet after the recommendation made by the JTC several weeks ago. However, the renewed pressure we are currently seeing on prices should be enough to send a signal to OPEC+ that they need to take action at the meeting. Failing to do so would mean only further downside to our current price forecasts.

We believe the market will be disappointed with anything that falls short of the JTC recommendation.

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