OPEC meeting: output set to jump

Heading into the OPEC meeting there were a range of predictions as to how much OPEC+ would increase output. Friday's OPEC meeting gave little detail, and as a result the market rallied strongly. However the OPEC+ meeting on Saturday offered more clarity, and the 1MMbbls/d increase announced gives us confidence in our view for lower prices

What was agreed?

OPEC+ members agreed that they will "strive" to return to 100% compliance with the production cut deal, rather than continuing to over comply with the current deal. This would see almost 1MMbbls/d of supply brought back onto the market, with this supply starting to return from 1 July. Given that not all members have the capacity to increase production, the supply increase will be filled by those who have spare capacity. This includes Saudi Arabia, Russia, UAE, Kuwait and

Algeria. Exactly how the additional production will be allocated has yet to be agreed, but the Saudi oil minister has said that it will be dynamic, to ensure that overall compliance of the deal remains at 100%. With a Joint Ministerial Monitoring Committee (JMMC) meeting set for September, we will be looking for more clarity on exactly how additional production will be allocated. The obvious risk for the market is that those who are able to increase output do so without consulting other members, seeing supply potentially increasing by more than the 1MMbbls/d or compliance starting to fall below 100%.

The Saudi oil minister has said that Saudi Arabia is already starting to respond with higher output, and so production numbers for June and July will likely show fairly significant increases, numbers for May already showed that the Saudis pushed production above 10MMbbls/d, the first time since August 2017. Meanwhile Russia should also be fairly quick to respond with higher production. It was previously reported that Russian oil output hit 11.1MMbbls/d in early June, above their individual quota of 10.95MMbbls/d.

Given that OPEC+ is set to bring almost 1MMbbls/d back onto the market over 2H18, we continue to have confidence in our view that prices will trend lower from current levels. As we wrote ahead of the meeting in our note Crunch time for OPEC, we were expecting OPEC+ to increase production by around 900Mbbls/d.

Why all the confusion over the increase?

"You can do the math"... the words of the UAE oil minister during the Friday press conference when questioned over what will the actual production increase be. The official press release from OPEC did not offer any new production targets for OPEC members, instead stating that OPEC would "strive" to meet 100% compliance but with no plan on how OPEC would achieve this. As already mentioned, reaching 100% compliance would be equivalent to increasing production by almost 1MMbbls/d. Given that not all members have the capacity to increase production, there were concerns that this "nominal" increase would be quite different to the "actual" increase, which some believed to be around 600Mbbls/d. Furthermore, there even appeared to be confusion between oil ministers, with them stating a number of different possible "actual" increases. If we were to see a supply increase of just 600Mbbls/d, this would make us rethink our view, given that this would push the market deeper into deficit over 2H18.

It was not until the OPEC+ meeting on Saturday that the market received more clarity over the production increase, with the Saudi oil minister suggesting that the "nominal" and "actual" increases should be fairly similar. This is due to the fact that production increases will be shared amongst those with spare capacity, rather than a pro rata allocation amongst all members of the pact. This however could lead to some tension between members of the pact, as those with spare capacity would gain market share at the expense of those members who do not have spare capacity.

Still plenty of uncertainty ahead

While we should see OPEC supply increase from current levels, there are still a number of question marks hanging over the market. Will supplies from Iran fall as a result of US sanctions? And if so, by how much? How much more will Venezuelan production decline? For Iran, we continue to assume that Iranian supplies will fall by 500Mbbls/d by the end of this year, whilst for Venezuela we are estimating that production will fall to 1.2MMbbls/d, from around 1.5MMbbls/d currently. The obvious risk is that we see steeper declines moving forward. However in theory, with OPEC+ aiming to hit 100% compliance, any shortfalls from Iran and Venezuela should be filled by other OPEC+ members.

Turning away from OPEC+ supply, there are growing concerns over the lack of pipeline takeaway capacity from the Permian in the US to the Gulf Coast. Given that further pipeline capacity is set to only come online in 2H19, some US producers may be reluctant to increase drilling activity due to infrastructure constraints. These constraints may mean that there is a risk that US output does not hit the EIA's forecast of 11.9MMbbls/d for 2019.

Finally, we will continue to keep a close eye on demand, and whether the current price environment will lead to any demand destruction. Furthermore the growing possibility of a trade war could have a negative impact on global demand growth. For now though, we continue to estimate global demand growing by 1.4MMbbls/d over 2018, and a similar number for 2019.

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