Article | 1 December 2017

OPEC production cut extension: It’s a done deal

As widely expected, OPEC and its allies agreed to limit their output until the end of 2018. However, Nigeria and Libya surprised as they agreed to cap their output at 2017 highs

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As widely expected by the market, OPEC and its allies agreed to extend their current production cut deal through until the end of 2018. This follows the Joint Ministerial Monitoring Committee recommending an extension on Wednesday. However there was one surprise from the meeting, and that was Nigeria and Libya agreeing to cap output.

What was agreed?

Heading into Thursday’s meeting, both OPEC and non-OPEC producers knew they would have to continue with the deal. Anything short of this would have disappointed the market, and given the significant speculative length in ICE Brent, this is something the group did not want to risk.

OPEC did go a little bit further than the market was expecting, with Nigeria and Libya, who were previously exempt from the deal, agreeing to cap their output at 2017 highs. To accommodate this, the agreement has been reset to run from January to December 2018. The group will also review the progress of the deal at their meeting in June.

Nigerian production hit a high of a little over 1.8MMbbls/d in August 2017, and so the cap for Nigerian output over 2018. This is in line with much of the talk in the early summer, where Nigeria said it would be willing to join the deal if they were able to maintain output at 1.8MMbbls/d. For Libya, this means capping production at a little over 1MMbbls/d. Libya aimed to produce 1.25MMbbls/d by the end of this year, a target they have struggled to reach. Capping output from these two nations is one less headache for the rest of OPEC, with production gains from them in 2017, offsetting a significant amount of the cuts from other members.

So what does this mean for the market?

We continue to hold our view for weaker prices moving forward. OPEC still has a challenge in front of them. While they have done a good job so far in drawing down inventories, they still have a long way to go to bring them in line with the five-year average. The Saudi oil minister said they want to see inventories fall by at least 150MMbbls from current OECD levels. The issue for OPEC is that the market is set to see a surplus over the 1H18, which if realised, would only see inventories grow.

Non-OPEC supply is set to grow by 1.4MMbbls/d over 2018. Unsurprisingly this growth is expected to be driven by the US, where the EIA expects output to average 9.9MMbbls/d for 2018, breaking the previous record of 9.6MMbbls/d. Clearly, with WTI trading above US$50/bbl, there is every incentive for the US industry to continue pushing output higher.

> Both the Saudi and Russian oil minister spoke about the importance of strong compliance over 2018. However we believe the longer the deal continues, the more likely we'll see compliance slip. Iraq has had poor compliance for most of the year, although recent disruptions in the Kurdish region has meant their compliance is improving. But once this is resolved, compliance is likely to slip once again.
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> Assuming Nigeria and Libya can increase output above their cap, we believe the idea of pumping more oil would be too tempting. Libya has a fiscal breakeven oil price of US$78/bbl, while Nigeria’s is even higher at around US$139/bbl. So both country's budgets are under pressure. One way to improve this is by simply pumping more.

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