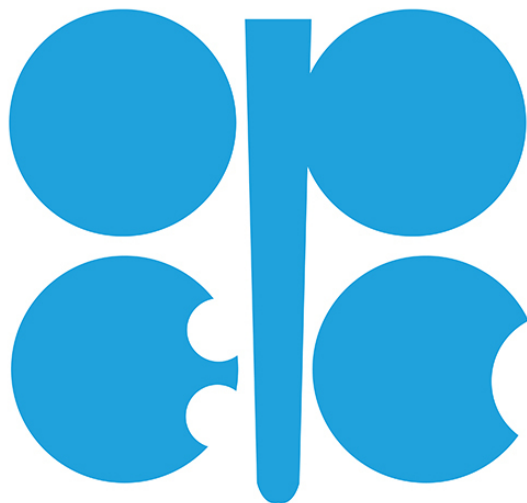


## Saudi Arabia makes a surprise oil output cut

The Saudis caught the market off guard, announcing that the Kingdom would make further voluntary cuts of 1MMbbls/d over February and March. This sizeable cut should provide the support the market needs amid Covid-19 uncertainties over 1Q21



# OPEC

### What was agreed?

Heading into the OPEC+ meeting, expectations were that the group would agree on either maintaining current output cuts at 7.2MMbbls/d or easing them by a further 500Mbbls/d over February. In fact, given the group was unable to come to an agreement on Monday, it looked as though members would struggle when they met on Tuesday again. The bulk were keen to keep

the current level of cuts, whilst Russia was pushing for a further easing of 500Mbbls/d.

By the end of the meeting it was decided that Russia and Kazakhstan would be allowed to increase output by a combined 75Mbbls/d in February, and then a further 75Mbbls/d in March. The rest would keep their output levels unchanged for the remainder of the first quarter.

However, the surprise was Saudi Arabia announcing that it would unilaterally cut its own output by a further 1MMbbls/d over February and March.

Therefore, over February and March, OPEC+ will be cutting by 8.125MMbbls/d and 8.05MMbbls/d, respectively.

## What does it mean?

Clearly, as demonstrated in the price action following the announcement, additional cuts are supportive for the market, particularly given that these additional cuts are meaningful. The action taken by Saudi Arabia does help to offset somewhat the uncertainty related to Covid-19 over the first quarter of this year, with several countries imposing new lockdowns or extending current ones. Clearly these lockdowns are a concern for oil demand and are certainly something that Saudi Arabia recognised as a key risk for the market moving forward.

The action taken by Saudi Arabia, along with the bulk of other OPEC+ producers maintaining current output levels means that the oil market should continue to draw down inventories over 1Q21, and as a result oil prices should remain well supported.

In terms of impact on the industry, any action taken by OPEC+ to support prices would be welcome news to US shale producers, with the boost in price potentially seeing producers more comfortable in increasing drilling activity.

For refiners, additional cuts would not be as welcome, with lower Saudi output not just constructive for flat price, but also differentials, and therefore we could see refinery margins come under further pressure.

## What risks remain?

In the current environment, there are several downside risks, and obviously a key risk remains Covid-19 and how the situation evolves in the months ahead, as countries wait to receive vaccines. New strains of the virus are a concern, however for now there is no suggestion that vaccines will not protect against these new strains, but this could easily change.

Away from Covid-19, another risk for the market is that other OPEC+ members get frustrated that Russia and Kazakhstan are increasing output, while they are keeping output unchanged. Therefore, there is the risk that other producers start to let compliance slip, particularly if they feel that Saudi Arabia will pick up the slack.

Finally, there remains a risk around how quickly Iranian supply could return to the market. However given the recent news that Iran has increased its uranium enrichment, it is less likely that we see the US lifting sanctions against Iran anytime soon.

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