The OPEC+ break-up: It's not you, it's me

OPEC+ knew they had to surprise the market, and that is what they did. Although the surprise was failing to come to a deal, rather than cutting more than expected. This changes the market outlook for the rest of the year, and as a result we have made significant revisions to our price forecasts - US$30/bbl here we come

Source: Shutterstock

From Russia with no love

It was a risky move from OPEC, and it clearly was a gamble that did not pay off. Following the conclusion of the OPEC ministerial meeting on Thursday, the group agreed to recommend to the wider OPEC+ group additional cuts of 1.5MMbbls/d through until the end of 2020, whilst also extending current cuts of 2.1MMbbls/d through until year-end. The key was to ensure that Russia was on board.

The outcome of the wider meeting on Friday was pretty clear - no deal. Russia was not willing to cut any more, and starting on the 1 April, members would be free to pump as much as they wanted. ICE Brent settled almost 10% lower on the day, and given the scale of the surplus about to hit the market, there is still significant downside to prices.

For the Russians, giving up market share to the US was the key factor behind not making deeper cuts. Russia can weather a lower price environment better than some of the OPEC members. The Russians have a fiscal breakeven oil price of below US$50/bbl, while the Saudis need around US$80/bbl. But clearly the expected downside to prices will be a growing concern for the Russians, especially if we see a prolonged period of weakness.

Surplus times ahead

We have revised lower our price forecasts for ICE Brent. For 2Q20, we are now expecting prices to average US$33/bbl vs. US$56/bbl previously. Given the scale of the surplus over 2Q20, we would not be surprised to see ICE Brent testing the lows seen in early 2016. Over the second half of 2020, we are assuming prices to average US$43/bbl.

While lower prices will likely have an impact on output, particularly from the US, this will likely only feed through to the market later in the year, and into 2021. Furthermore, inventory builds over 1H20 will likely mean only limited upside to prices over 2H20. The key assumption to our forecast is that OPEC+ do not have a change of heart, and agree to further cuts down the road.

The end of the deal risks bringing 2.1MMbbls/d of supply back to the market, and it is also not unrealistic to think that Libyan output may return to normal in the coming months, bringing a further 1MMbbls/d of supply to the market. This 3.1MMbbls/d of additional supply would come at a time when the market was already set to be in surplus over 2Q20, while the demand picture remains uncertain, but clearly fragile due to Covid-19. indeed, there are growing expectations that we will actually see a contraction in consumption this year, rather than just a slowing in consumption growth as Covid-19 spreads. For now, though, we are still assuming modest consumption growth over the year.

ING oil price forecasts

New Forecasts	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
ICE Brent (US$/bbl)	53	33	40	45	50	60	60	63
NYMEX WTI (US$/bbl)	48	28	35	40	44	54	54	57
Previous Forecasts								
ICE Brent (US$/bbl)	55	56	60	65	64	70	70	68
NYMEX WTI (US$/bbl)	50	50	53	58	57	63	63	61

Source: ING Research

Let the price war begin

The failure to reach a deal means that we are set to see a price war, and the Saudis have reacted quickly, already throwing down the gauntlet by cutting the April official selling price (OSP) for its crude oil significantly. The Light Arab crude's official selling price (OSP) into Asia was reportedly slashed by US$6/bbl, to a discount of US$3.10/bbl to the benchmark. While into Europe, the OSP for most Saudi grades was reportedly cut by US$8/bbl. This sees Arab Light into Europe over April at a US$10.25 discount - levels not seen at least since May 2002. Will these severe OSP cuts from the Saudis be enough to make the Russians reconsider? Only time will tell.

The aim of the Russians is to put pressure on the US oil industry, and while this may work in the medium term, it is less certain what the longer-term impact will be. When OPEC tried this last time around, the US oil industry bounced back stronger and more efficient than before. Projections prior to the OPEC+ meeting were that US supply would grow by 960Mbbls/d this year and just 350Mbbls/d in 2021. Clearly weaker prices moving ahead means only further downside to these numbers.

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