Crude oil: Crunch time for OPEC+

This week could not have come soon enough for OPEC, with ICE Brent having fallen by more than 30% since early October. Now the question is, will OPEC+ cut output and by how much? Russia appears to be the main obstacle. However, we believe the group has little option but to cut

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OPEC meeting schedule

The remainder of this week is packed with various OPEC+ meetings. Wednesday sees the Joint Ministerial Monitoring Committee (JMMC) meeting in Vienna, where the group will certainly discuss the best course of action to take and ensure all parties are on board for proposed cuts.

The JMMC meeting will be followed by the official semi-annual OPEC meeting on Thursday morning, with a press conference at 13.00 CET, although as previous meetings have shown, this is often delayed. Then finally on Friday morning, OPEC+ will be meeting, which importantly includes Russia. Once again a press conference at 13.00 CET is scheduled, following the meeting.

Uncertainty still remains

The message following the G-20 summit in Argentina was pretty clear- Russia was keen to continue its cooperation with Saudi Arabia into 2019, laying the groundwork for production cuts to be announced at the OPEC meeting in Vienna on Thursday and Friday.

However, more recent reports suggest that while Russia is willing to cut output, it's not willing to cut as much as some think is needed. Media reports suggest that Russia wants to cut by a maximum of 150Mbbls/d, which, if based on November productions levels, would still leave Russian output around 250Mbbls/d above its target production under the 2016 deal. This would mean that OPEC, and in particular Saudi Arabia, would have to shoulder a larger share of the cuts. OPEC's Economic Commission Board last week recommended that the group cut production by 1.3MMbbls/d.

The other big unknown is how President Trump will react to any production cuts. He has been very vocal about keeping oil prices low, and the concern for the market is that the US administration will use the murder of journalist Jamal Khashoggi as leverage. While we believe that President Trump will be reluctant to escalate the situation, the Saudis are likely to choose the wording of any statement with regards to cuts very carefully.

What do we see happening?

Given the scale of the surplus over 1H19 we believe that OPEC+ will have to agree to a cut of around 1.2MMbbls/d for the first six months of next year. A reduction of this size should leave the market balanced in the new year. Previously, we were expecting a cut of closer to 1.5MMbbls/d, however Canada has helped the group out by announcing that producers in Alberta will be cutting output by 325Mbbls/d as a result of deeply discounted differentials.

Still, given the pressure from President Trump on Saudi Arabia to maintain output at current levels, we may see an announcement from the group that does not give an explicit number. Instead, there is the possibility that they say producers will strive to return to individual compliance of the 2016 deal, rather than looking at compliance as a group. If this is the case we would need to see fairly large cuts from Saudi, the UAE, Kuwait and Russia. Theoretically, Iraq would also have to make significant cuts, but given that they have not complied with the deal since it was implemented, it is unlikely that they will start now.

We believe confirmation of a 1.2MMbbls/d + cut should see ICE Brent trending back towards US$70/bbl in the near term. Given the level of uncertainty going into these meetings, speculators do hold a fairly neutral position, and so a positive outcome would leave them with significant room to increase their long positioning. The latest COT data shows that speculators held a net long of 168,512 lots as of the 27 November- the smallest net long held since the end of 2015, and off from a peak of 632k lots back in April this year. Meanwhile, for every spec short in the market there are 2.6 spec longs- this ratio was above 20 earlier in the year.

What will the market view as disappointing?

We believe that anything below a 1MMbbls/d cut will be viewed as bearish by the market, as this still leaves the market with a fairly sizeable surplus over 1H19, even taking into consideration the cuts from Canada. This outcome would likely see us revise our price forecasts lower for 2019.

Author

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

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