The OPEC flip-flop

After meeting in Abu Dhabi over the weekend, OPEC officially decided against announcing a return to production cuts. However, they appear to have laid the groundwork for announcing adjustments at their next meeting. As things stand, we think cuts over 2019 are unavoidable

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What was agreed?

The one thing that members at OPEC's joint ministerial monitoring committee seemed to agree on was the fact that the global oil market is likely to be oversupplied in 2019, with the group seeing higher supply growth than is needed. Despite highlighting this view, they stopped short of announcing any coordinated approach to tackling the potential surplus over 2019.

Instead, the group needs more time to see whether production adjustments will be needed, given that there is still plenty of uncertainty related to trade wars and the impact of US sanctions on Iran. Therefore a decision has been pushed back to the next meeting on 5 December, the day before OPEC's semi-annual meeting. The Saudi Energy Minister suggested if cuts were to be made, then the baseline should be from a more recent period- like October 2018 levels.

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While secondary production numbers are yet to be released by OPEC, Bloomberg estimates show that production over October totalled 33.33MMbbls/d - the highest monthly production since November 2016. If a more recent baseline is used, this would be advantageous to those producers who have been able to increase output in recent months, while those who have struggled, and seen output fall, would be worse off. More recent comments from the Saudi Energy Minister point towards a potential cut of around 1MMbbls/d, however, the Russians once again seem more reluctant to rush into making a decision.

What is the most likely course of action?

We believe that OPEC+ will agree on production cuts at their next meeting in early December. It is becoming clearer that as we move closer towards 2019, the market will see a sizeable surplus at least over the first half of 2019.

Given the bulk of the surplus next year sits in the first half of the year, we think any OPEC+ cut would be for an initial period of six months, with the situation reviewed at their semi-annual meeting mid-year

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Previously, the balance sheet over the last quarter of 2018 was pointing towards a fairly sizeable global deficit, however strong US output growth, coupled with a strong response in production from Russia and Saudi Arabia has seen this deficit largely disappear. This is also reflected in the front end of the ICE Brent curve, with it now comfortably back in contango.

Comments from Saudi Arabia suggest that cuts could be as much as 1MMbbls/d, however, while the Russians appear to be on board with potential cuts, they will likely be less convinced to make such a large cut, at least initially. Given that the bulk of the surplus next year sits in the first half of the year, we are of the view that any OPEC+ cut would be for an initial period of six months, with the situation reviewed at their semi-annual meeting mid-year.

> The key downside risk for the market is if OPEC+ does not agree on a cut at their December meeting. The takeaway from this weekend's meeting was that a deal was more than likely, and so failing to reach one in early December would come as a surprise to many in the market.

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