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Frontier Markets Specialists

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‘Core’ OPEC members + Russia will buck Vienna deadlock and raise production

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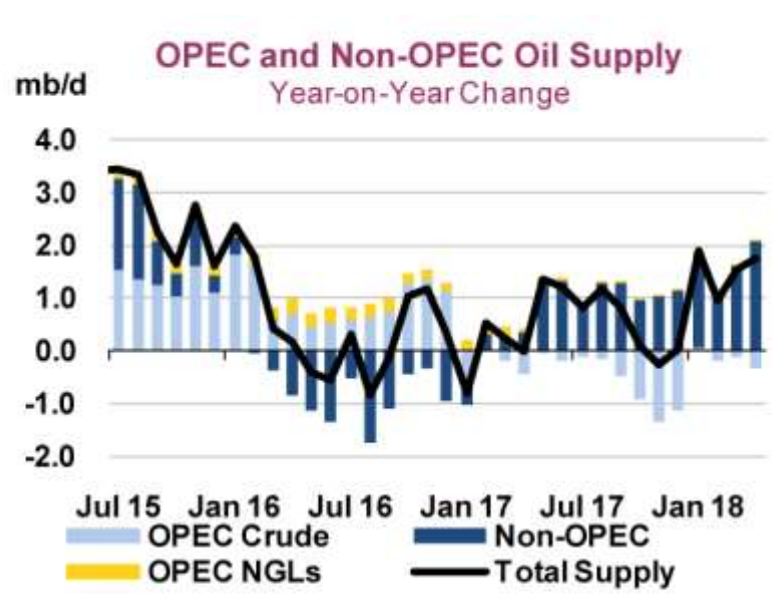
As Saudi Arabia’s oil minister Khaled al Falih stated in Moscow on June 14, it is almost “inevitable” that the core members of OPEC along with Russia and Oman will begin to increase crude oil production this summer to rein in oil price increases. The shift in the Saudi stance, which they first telegraphed to the market on 25 May, was clearly in part a response to pressure from the Trump administration, but also to the collapse in Venezuelan output. The Russian oil industry has been arguing even since before the December 2017 OPEC meeting that the price increases would eventually prove unsustainable if pushed too far, due to the growth in US shale and other competing production.

What is much less clear is whether OPEC as a group will formally endorse the production increases, since their by-laws require a unanimous decision to adopt any new policy. The “headline” does not matter much, as all of the countries with spare capacity are on board with the decision to increase. Actual production will probably increase by at least 500,000 bpd over the summer and continue a gradual upward trend into the fall. An actual production increase of one million bpd or more immediately is not likely, given capacity constraints, regardless of the “headline.” This will leave the market with a slight downward bias over the summer as precipitous inventory declines are avoided, but not a collapse below the $60s for Brent. With the issue of Iran’s potential withdrawal from the JCPOA looming, geopolitical risk could easily come back into play in late summer or early fall.



Source: IEA Monthly Report (June 2018)

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DaMina Advisors is a preeminent Africa-Asia focused independent frontier markets political risk research, due diligence, M&A transactions consulting and strategic geopolitical risks advisory firm.

DaMina Advisors is legally registered and has offices in the US, Canada, The UK and Ghana. DaMina is headquartered in Toronto.

The 22 June OPEC meeting will be the most contentious since June 2016, but the 'headline' is irrelevant

The situation within OPEC and the non-OPEC countries cooperating with production cuts now is almost the opposite of what it was back when the agreement to cut 1.8 million bpd was made in December 2016. In early 2017, as the agreement was being implemented, most of the cuts made by the non-OPEC countries other than Russia and Oman were simply taking credit for decline rates which were already included in market expectations. The Saudis initially implemented a larger cut than they had committed to, as the UAE took a bit longer to come into compliance for technical reasons. Iran had finished its remarkable 800,000 bpd increase by end of 2016 as it recovered from sanctions after reaching its implementation goals for sanctions relief in January 2016, and was not asked to participate in cuts, just accept a cap.

As we approach the June 22 OPEC meeting and the question of a production increase, there are many of the original participants which are effectively irrelevant due to their inability to increase their production in the near-term. Venezuela is declining rapidly, and Iran has seen a modest decline in recent months as hoped-for investment failed to materialize. Only Saudi Arabia, the UAE, Kuwait, and Russia have the ability to rapidly increase their production volumes by more than 100,000 bpd. Iraq has a small amount of spare capacity, but never came into full compliance with the agreement. Several others have small amounts.

Outside OPEC, Russia can probably restore its 300,000 bpd cut by the end of the year if it started work over the summer. Oman's 45,000 bpd cut also could be restored. Given these constraints, the substantive discussion will really involve the four major players with at least 100,000 bpd of spare capacity. All of them are favorably disposed to at least a gradual increase at this point. Russia has reportedly proposed a full rollback, while the Gulf Arabs would prefer an agreement on a more modest increase in targets. The political concerns the Saudis and the UAE have about their relations with the Trump administration have also become a bit more pronounced over the last month. Saudi and Emirati resistance to US pressure to settle their dispute with Qatar to present a more united front against Iran has caused tensions, and the Saudi/UAE backed offensive against the Yemeni port of Hodeidah to cut off supplies to Houthi rebels has caused renewed rumblings in the US Congress about linking military sales and support to humanitarian concerns about the war. Thus, the Saudis and Emiratis have even more reasons to avoid disappointing President Trump on the issue of containing US gasoline prices, which Trump sees as a factor in the US midterm elections.

Some OPEC members will probably deny the main players a unanimous decision on an increase

On the other side are Iran, Venezuela, and Iraq. Iran sees the Gulf Arab members as profiting from their market share loss under sanctions, which is already beginning to show up in European refiners winding down their purchases of Iranian crude oil, and has no incentive to sign off on a formal increase. Saudi Arabia is sure to snub their request for an OPEC statement of support for Iran against US sanctions. Venezuela also has no reason to endorse an increase, as there is nothing they can do to reverse their production declines in the near-term and higher per-barrel oil prices are the only positive economic news they've seen in years. Finally, even though they have a small amount of spare capacity, Iraq has recently come out as opposed to an increase, as they have been to a large extent a free rider on cuts from others, and have acute financial problems.

An agreement which sets out a full list of realistic production targets acknowledging this reality is possible, but faces major hurdles. The other two outcomes, either a failure to agree on formally changing the original agreement, or a unanimous agreement on some vague formulation without clear targets, are not really different in terms of how the countries with the capacity to increase production will actually behave. However, the 'headline' always creates a ripple in the market, and a lack of agreement on a quantified rollback of cuts would avoid sharper downside on the news.

Iran's stance on the JCPOA remains a major wildcard in the late summer and fall

Apart from the OPEC/non-OPEC production cuts beginning to be reversed, the future of the JCPOA remains a major variable for the oil market toward late summer and into the fall. As we have outlined in a previous note on 29 May, European governments will fail in their attempts to ensure the continuing economic benefits of the JCPOA for Iran due to the massive exposure their oil companies and large banks have to the US market. Iranian officials have stated that they could resume activities banned by the JCPOA if those economic benefits are undermined, but the actions they have taken thus far – like doing some of the initial work to facilitate increased uranium hexafluoride production – do not violate the agreement. There is no sign a withdrawal is imminent, but it also is not likely that Iran will adhere to the terms indefinitely after the total US withdrawal. We will continue to monitor this closely as the timing on this move will be important.

Contact: Stephanie@DaMinaAdvisors.Com

To schedule any in-depth Q&A's with Greg Priddy on OPEC summit

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