4 December, 2020

The Organization of the Petroleum Exporting Countries (OPEC) and its allies will discuss its production cut target next year. The result will have a significant impact to oil prices in the coming months.

Originally the Organization of the Petroleum Exporting Countries had meetings in Vienna this Monday and Tuesday to discuss whether to maintain the existing oil output cuts (7.7 million barrels per day) in Q1 next year.

The market believes that the OPEC+ will agree a three-month postponement for increasing oil output

As agreed, the OPEC+ will reduce the existing oil output cuts by 2 million barrels per day (bpd) starting from January 2021. But with the recent resurgence of severe COVID-19 spread in Europe and the U.S., it is expected that the demand for oil will be under significant pressure amid the coronavirus pandemic. Thus, the group has been considering to maintain existing cuts of 7.7 million bpd into Q1 2021. The OPEC+ suggested to defer the scheduled production increase by 2 million bpd to April 2021.

Even though the OPEC+ is able to reach an agreement in maintaining the existing oil output cuts at 7.7 million barrels per day in Q1 2021

We think that the oil prices had already priced in the such positive news in the past two weeks. Thus, even there is an agreement in maintaining the existing production cuts, it may not have a huge stimulus to the oil prices in short term.

In contrast, if the OPEC+ fails to reach an agreement to extend the existing production cuts

There may be a 5-10% downside risk to the oil prices. The oil price had been recorded over 25% rise in

November on the hopes on vaccines as well as the soar of stock market. The current oil price has been neglected the severe resurgence of the coronavirus across Europe, the U.S. or even the world, triggering the new restrictions, hitting economic activities and oil demand.

Oil rose over 25% since November, triggered by the hopes on vaccine and stimulated by the surge in the stock market

Source: Bloomberg

Any unexpectedness in the meeting?

There were rumors about some major oil producers in the Middle East, such as Iraq and the United Arab Emirates (UAE), had slight comments on the decision to extend production cuts. They believe that they should grasp the recent surge in oil prices and increase production in order to maximize their profit. Adding to the challenge, the Deputy Prime Minister of Iraq criticized the OPEC+ last week that the OPEC+ should have taken all members' economic and political conditions into considerations when making decisions on the introduction of production quotas. However, the market believes that Iraq's move is an excuse to request less production reduction. Further complicating the picture, there was a market rumor that the United Arab Emirates, being the third largest oil producer in OPEC after Saudi Arabia and Iraq, has questioned about whether joining the OPEC is beneficial to its own. And rumors said it has been considering withdrawal from OPEC. The market believes that if the rumors are true, the UAE intends to force Saudi Arabia, the leader of the OPEC, and Russia, the largest alliance country of the OPEC+, to negotiate for a lower output cuts.

Indeed, there are always huge conflicts of interest among OPEC+ members when it comes to allocating production cuts. Disagreements could lead to a collapse in talks and delayed or even overturned the entire production reduction plan. The last dispute had just happened in March this year. Due to the severe differences between Saudi Arabia and Russia on the production reduction target, Saudi Arabia in response to Russia's refusal to oil production cuts, increased production dramatically and resulted in a sheer drop of oil price by 40%.

The latest update

OPEC+ agreed to ease oil-output cuts next year after almost a week of fraught negotiations that exposed a new rift at the heart of the cartel. The group will add 500,000 barrels a day of production to the market in January, and ministers will then hold monthly consultations to decide on the next steps.

For any comments, please send email to us at info@asset-mg.com.

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