30 November 2016

Flash Comment International

Oil deal more important for OPEC's reputation than the oil market

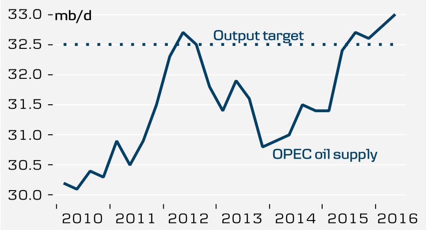
- **OPEC has agreed to cut output to 32.5mb/d effective from 1 January 2017.**
- **The deal is contingent on contribution of 600kb/d cuts from non-OPEC producers.**
- **The announcement has led the price of Brent crude to rise to USD50/bl.**

The Organisation of Petroleum Exporting Countries (OPEC) has just announced that it has agreed to reduce production following weeks of negotiations finalised at its meeting in Vienna today. OPEC will aim to lower output to 32.5mb/d by 1 January 2017. The deal is contingent on non-OPEC producers cutting production by 600kb/d. According to OPEC Russia has already committed to delivering 300kb/d in cuts. OPEC will have a meeting with non-OPEC producers to finalise this on 9 December. Indonesia, which is a net oil importer, suspended its membership. However, this does not affect the size of the output cut. Iran has been exempted from reducing output and allowed a small rise in crude production from current levels. The monitoring of output cuts will be based on secondary sources. OPEC will publish a table on individual members' output targets. The deal is set to be reviewed at the next meeting on 25 May 2017.

The lack of real commitment from OPEC today (deal is contingent on meeting with non-OPEC producers) highlights that present conditions make it difficult for OPEC to succeed as a cartel. OPEC's position on the oil market is under pressure from the emergence of alternative fuel sources, large shale-oil reserves in, e.g. the US, staggering world oil demand under pressure from weak global economic growth and a strong dollar and finally lack of compliance within OPEC. If OPEC manages to get more countries on board, i.e. effectively expanding the cartel, it will, however, get a firmer grip on the oil market. We, probably along with the oil market, will await the deal's actual implementation. The failed attempts at a deal over the past year as well as the fragile state of public finances in most OPEC member countries mean that the oil market is likely to test OPEC compliance with the deal. Hence, if it is implemented it may push oil prices a bit higher.

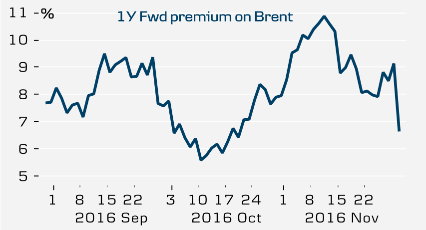
The price of Brent crude has climbed to around USD50/bl on the deal, which in the big picture is a quite muted response. The reaction has been greater at the front end of the Brent crude forward curve, thus leading to a narrowing of the contango by about 2% on a 1Y horizon. This reaction may reflect either a lack of confidence in the longevity of this deal or an expectation that it will lead to higher output from, e.g. US shale producers, partly offsetting the effect of the output cut. Nevertheless, we look for oil prices to head higher in 2017. This is based on our expectation of higher global economic growth and inflation, in particular in the US economy, the world's leading oil consumer, which should support growth in oil demand. In one year's time, we also look for the USD to trade at a lower level than today, which supports a higher oil price. We expect the price of Brent crude to rise to USD58/bl in Q4 17.

OPEC to cut output to 32.5mb/d



Source: Macrobond Financial

Contango in oil forward market has narrowed



Source: Macrobond Financial

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