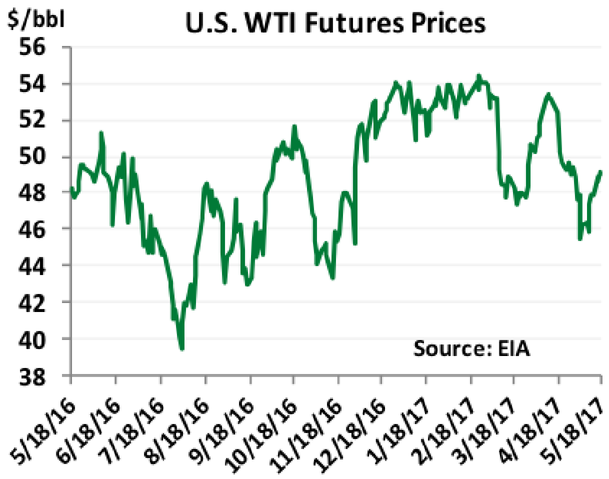
Oil Producers Working to Extend Supply Cuts at Upcoming Vienna Meeting. By Diane Munro

General view of a meeting of OPEC oil ministers at their headquarters in Vienna, Austria, Dec. 4, 2015. (AP Photo/Ronald Zak)

Global oil markets remain volatile ahead of OPEC's May 25 ministerial meeting on expectations that the producer group and its non-OPEC partners will extend production cuts until the end of 2017. The alliance agreed to reduce production by a collective 1.8 million barrels per day (mb/d) from January to June in a bid to rebalance oversupplied oil markets. Mounting concerns that resurgent U.S. oil production will offset lower supplies have led to oil prices trading in a volatile and wide range of $7.50 per barrel (bbl) since mid-March, with U.S. West Texas Intermediate (WTI) futures falling to a five-month low of just $45.88/bbl on May 9.

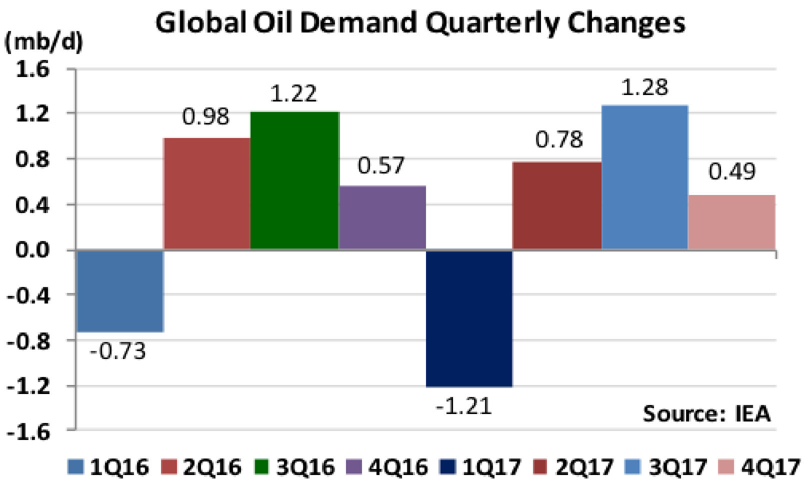


Oil prices reversed course and rose after OPEC officials said on May 10 that an extension of the agreement until the end of the year was all but assured, and jumped again on May 15 following a joint announcement by Saudi Arabia and Russia that they will try at the May 25 ministerial conference in Vienna to bring all members on board for an extension of the agreement, not just until the end of the year, but to March 2018. Prices edged marginally lower, however, after the International Energy Agency (IEA) cautioned in its May oil market report that the pace of rebalancing oversupplied markets was even slower than expected in April due to the lingering impact on supply from

OPEC's production surge at the end of 2016 before the new accord took effect. Prices have recovered by around $3/bbl over the past week, with WTI last trading at $48.65 and international benchmark Brent at $51.75/bbl.

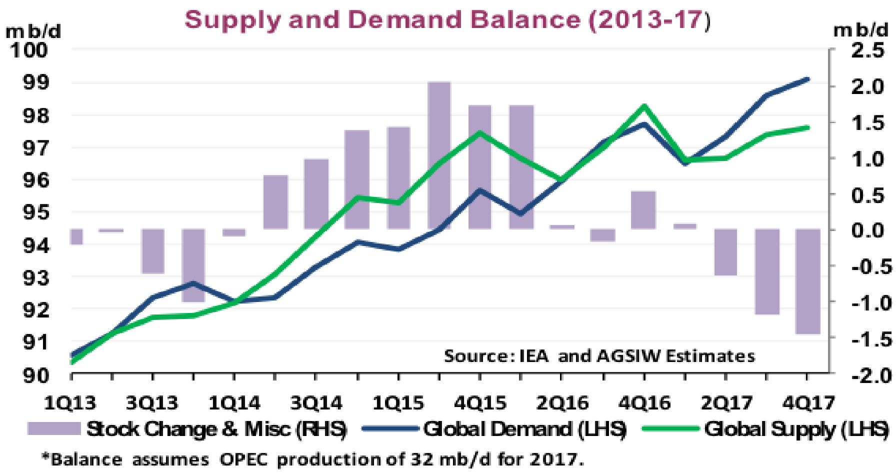
Oil Demand on Track to Outpace Supply

Global oil demand is forecast to rebound in the second quarter after a weak first quarter. On a quarter-to-quarter basis, global demand growth is expected to post the strongest gains in the third quarter, up by 1.28 mb/d. Despite the faster than expected recovery in shale oil supplies, OPEC's efforts to rebalance oil markets are clearly showing progress now. Global oil demand growth is forecast at 1.3 mb/d on average, to 97.9 mb/d on an annual basis for 2017, unchanged from the IEA's forecast in April. Assuming OPEC holds production at 32 mb/d for the July-December period, global oil supplies are projected to rise by just 80 kb/d on average, to 97.1 mb/d.



As a result, a drawdown in global stocks of an estimated 800,000 barrels per day (kb/d) is needed to meet the supply shortfall in 2017. However, the anticipated drawdown in stocks for the first quarter failed to materialize after the IEA made downward revisions to its demand data and upward revisions to supply. Instead of a projected draw of 250 kb/d, global inventories rose by a modest 80 kb/d, which is still much lower than the 540 kb/d increase posted in the fourth quarter of 2016. Global oil stocks declined by a steep 1.3 mb/d in March, with OECD inventories falling by about 1 mb/d and the remainder coming from reduced volumes in floating tanker storage and non-OECD countries.

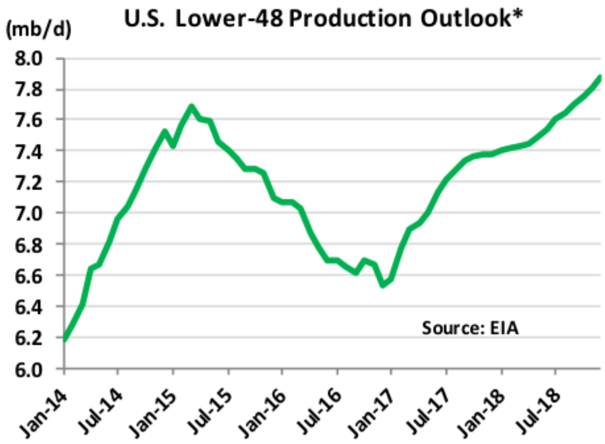
Going forward, global oil stocks are expected to decline on a quarterly basis, falling by around 600 kb/d in the current April-June period and, assuming OPEC extends its agreement for the full year, accelerate to 1.1 mb/d in the third quarter and to 1.5 mb/d in the final three months of the year. The IEA reported crude oil inventories in OECD countries are still a steep 3.25 billion barrels compared with a more normal five-year average 2.7 billion, which the industry uses as a benchmark measure of a balanced market. Based on current estimates, stocks are forecast to decline by 290 million barrels by the end of the year, bringing them to 2.73 billion barrels, just shy of the five-year average.



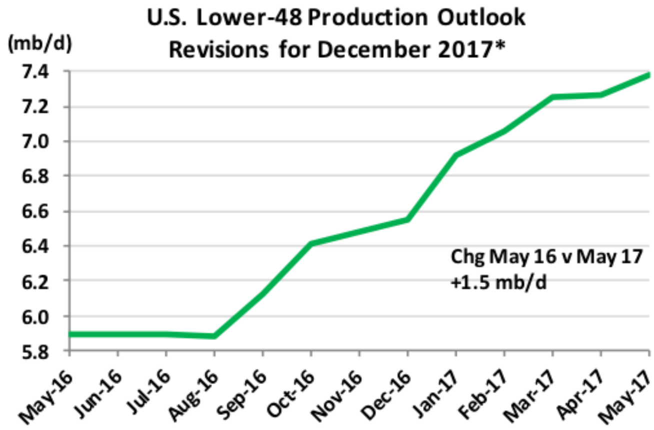
Upward Revisions to Non-OPEC Supply Continue

The steady upward revisions to non-OPEC supply since the Vienna agreement in late 2016 may continue to temper the pace of rebalancing this year. This month the IEA raised its outlook for non-OPEC supply by 100 kb/d, to 58.3 mb/d, which is an increase of 600 kb/d over 2016 levels. Oil production from Canada, Brazil, and Kazakhstan are forecast to increase supplies by a collective 620 kb/d, the IEA said. Nevertheless, the industry continues to focus on the unexpected strong increase in U.S. crude oil production, which the IEA now projects will rise by around 350 kb/d on average this year. The annual increase masks the accelerating upward trend in U.S. crude production, which is expected to end 2017 approximately 800 kb/d higher than at the end of 2016, according to the IEA.

The U.S. Energy Information Administration (EIA) has also raised its forecast for U.S. crude oil production in its latest monthly report, and now sees even stronger growth than the IEA, with supplies rising by 960 kb/d between December 2016 and December 2017. The EIA revised its forecast for total U.S crude oil production higher for both 2017 and 2018, to an average 9.3 mb/d and almost 10 mb/d, respectively. The outlook for Lower-48 production, which includes tight oil, for the end of 2017 has been sharply increased by 1.5 mb/d over the past 12 months, with the EIA forecasting production will reach 7.4 mb/d by December. The EIA's forecast for Lower-48 production in December 2018 also has been raised each month since its first release in January, with upward revisions totaling a steep 900 kb/d to 7.9 mb/d.

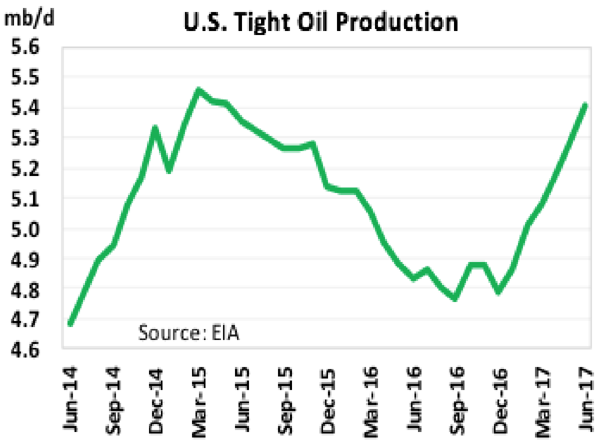


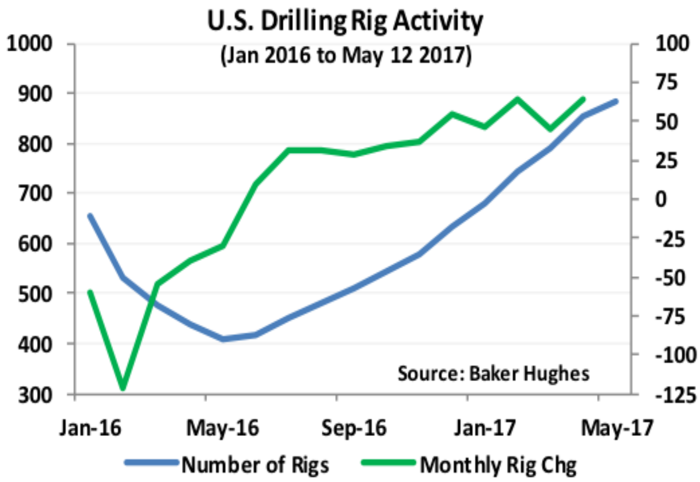
* Excludes Gulf of Mexico.



* Excludes Gulf of Mexico. Source: U.S. EIA Short-term Energy Outlook

Underpinning robust U.S. production and upward revisions to industry forecasts, including from the IEA, is the fact that a significant portion of projected shale oil output was hedged in the futures market at the end of 2016 and earlier this year – U.S. independent producers locked in future cash flows and sales prices when the market was much stronger, which ensured they have the funds to increase development. As a result, U.S. drilling rig activity has more than doubled to 885 rigs by mid-May from 407 in May 2016, according to Baker Hughes. The increased drilling activity is behind the EIA's forecast for six consecutive months of increases, with tight oil output expected to reach a two-year high in June. Driven by a robust recovery in Texas, tight oil output in the major shale oil plays is forecast to increase by around 120 kb/d to 5.4 mb/d in June, according to the EIA's latest drilling productivity report.





OPEC Readies for Ministerial Meeting

With a week to go, the major players in the OPEC and non-OPEC alliance are preparing their playbook for the May 25 ministerial meeting. The significant upward revisions to U.S. tight oil production have not only rattled oil markets, but are also behind the drive by Saudi Arabia and Russia to extend production cuts into 2018. In a joint press briefing with Russian Minister of Energy Alexander Novak in Beijing following a meeting of the G-20 countries, Saudi Arabian Minister of Energy, Mines, and Mineral Resources Khalid al-Falih said, “There has been a marked reduction to the inventories, but we’re not where we want to be in reaching the five-year average.” He added, “We’ve come to the conclusion that the agreement needs to be extended.” The IEA said in its May report that a slower pace of recovery means that global stocks are not expected to fall within the five-year average range until 2018.

OPEC has continued to produce close to its new lower targets, with compliance with the agreement at a strong 96 percent in April. The IEA estimated OPEC production was up modestly month on month, to 31.8 mb/d, with marginally higher supplies from Nigeria and Saudi Arabia partially offset by lower output from Libya and Iran. The OPEC Secretariat estimated the group’s production was slightly lower in April at 31.7 mb/d based on its survey of secondary sources. In its direct communication to the Secretariat, Saudi Arabia reported its production at 9.85 mb/d, or about 45 kb/d above April levels. Overall compliance with new targets improved for non-OPEC producers in April, to 66 percent compared with just 51 percent in March, the IEA reported. The non-OPEC countries reduced supplies by a further 85 kb/d in April from March levels, with Russia accounting for the lion's share. April production cuts reached 370 kb/d compared with the group's pledge to lower output by 560 kb/d. Russia reduced output by a further 55 kb/d in April and reported it met its target to cut supplies by 300 kb/d on May 1.

Saudi Arabia and Russia, which combined account for just under 50 percent of the total 1.7 mb/d production level agreed to by the 24 countries, are facing several hurdles as they work to extend the cuts through the first quarter of 2018. Kuwait and Oman have already come out in support of the proposal but Iraq has said it will not extend its cut beyond the end of the year, while Kazakhstan made it clear that its participation even after June will have to be on different terms.

OPEC Reaps Billions in Extra Revenue

OPEC negotiators may also have a strong argument for maintaining cuts based on estimates that the group has earned billions more in revenue while pumping fewer barrels. The IEA estimates that in the first quarter of 2017 OPEC members' revenue rose to $1.66 million per day compared with $1.58 billion a day in the fourth quarter of 2016 based on the OPEC basket price and despite sharply lower production of 1.38 mb/d. The net increase for the quarter is estimated at $6.65 billion for the first three months of the year. The OPEC price basket rose to $52.03/bbl on average in the first quarter of 2017 compared to $47.59/bbl in the fourth quarter of 2016. The IEA calculated Iran posted the largest increase in revenue at $15.2 million per day to $197 million per day while Saudi Arabia earned an estimated $12.5 million per day more, to $515 million per day.

The more optimistic market analysts are pointing to comments by Saudi Arabia and Russia in Beijing that they are prepared to "do whatever it takes" as a crucial indication that the group is prepared to stay the course until markets fully rebalance sometime in early 2018. With OPEC pre-empting the meeting's outcome with its announcement of a planned extension until March 2018 and a corresponding jump in futures markets, analysts say the room for further price increases is limited until a significant drawdown in global oil stocks accelerates in the third quarter.

(*) Diane Munro is a non-resident fellow at the Arab Gulf States Institute in Washington.

Source: The Arab Gulf Institute in Washington, May 18, 2017

http://www.agsiw.org/oil-producers-working-extend-supply-cuts-upcoming-vienna-meeting/