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ANALYSIS

# Opec will need to extend the new normal, but how it gets everyone to stick with production cuts is still shrouded

**By Samuel Merlin, Special to Gulf News**

Three months into Opec's historic deal to cut member production and one key question remains, what has the production cut achieved? Opec's goal for the production target was to "accelerate the ongoing drawdown of the stock overhang and bring the oil market rebalancing forward."

This 1.77 million barrel per day (mbpd) cut between Opec (1.17 mbpd) and non-Opec members (0.60 mbpd) only lasts for the first six months of 2017. So how likely is Opec to achieve its goals in such a short period of time?

On the announcement of the adoption of the Algiers Accord, Brent prices not surprisingly bounced up towards $55 (Dh201.85) per barrel. In the first three months of the deal, Opec compliance with the production cuts has been overwhelmingly successful at 82-98 per cent of the cuts being implemented.

As such, Brent has stayed relatively flat and price outlooks for the next three months (being the last three months of the deal) are generally in-line or marginally growing at that $55 level.

But, while Opec's plan seems to be achieving its primary goal in stabilising oil prices, truly rebalancing the market is not something that can be achieved in the next three months, or even an additional six months should Opec members extend the agreement.

Two key macro trends outside of Opec's control render that decision at the behest of the market, not its leading cartel:

1) Key producing countries are increasing their crude stockpiles, not selling them down; and

2) Opec members and exempt countries are growing daily production at significant levels

**US a swing producer**

Volumes of crude being stored in the US, EU and China continue to grow and as they're released can have significant impacts on commodity prices. In January alone the EIA reported US crude stocks rose by approximately 30 mbbls and with production up 300,000 barrels per day (kbpd) from September to November 2016 and an additional 100 kbpd projected in 2017.

Even with sales of strategic reserves the US will remain a major swing producer due to both resiliency of shale at lower prices and growing stockpiles of crude which can be sold as prices begin to grow.

Within the cartel itself, members flooded the market and began to store crude before the cuts were implemented. Members pumped 600—1,100 kbpd more in the three months from the Algiers

Accord at the end of September to deal implementation in January than they had one month prior to the original accord.

Further, a few major Opec producers have the near term ability to ramp up production in such a quantum that would neutralise Opec's 1.17 mbpd cut.

Nigeria has begun to implement agreements with militants in the Niger Delta that have among other pipelines kept the Trans Forcados Pipeline and Forcados Oil Terminal and its 400 kbpd capacity closed for the entirety of 2016. Current Nigerian production is up to 1.44 mmbpd and growing. Once midstream infrastructure is secure, this "shut-in" production can easily come back to market and bring Nigeria back towards historic levels of 1.8-2.0 mbpd.

Libya, which has been rocked by war for the past three years, has signed successive oil marketing contracts in the past month with Glencore and Rosneft. This gives a soft guarantee that production that gets to terminal will be marketed.

Unless these traders had strong comfort around security to get to port, fill and discharge, they would never move a vessel into Libyan waters. Libyan production has risen by nearly 700 kbpd through January as a result.

**Underwhelming compliance**

Other Opec members Kurdistan (by way of Iraq) and Iran continue to award concessions, grant field development approvals and sign new marketing contracts, paving the way for near term production growth. Even Kazakhstan, with nearly six months of constant production coming from the giant Kashagan field and a $37 billion expansion underway at Tengiz, has significant volumes it can add to the market.

This doesn't even factor in the few Opec members not meeting their production quotas with underwhelming compliance.

With three months down and three to go, Opec is realising its goal. But, the volumes of produced and stored crude are coming into the market whether Opec can control it or not. Rallying members to extend the accord for an additional six months will only bring with it what has been achieved thus far — temporary price stability.

However, at some point production and stored volumes will overcome any Opec rules, leaving Opec in a position where it has done enough in a short period of time to keep prices stable, but nonetheless in a less powerful role. At that point the only one question will be about optics and how Opec will spin the message.

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