Oil markets

Oil prices steady as OPEC achieves historic compliance with output cut pledge

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Highlights

- **Oil prices range-bound in February around $55/bbl (Brent) and $53/bbl (WTI) for the third consecutive month.**
- **OPEC achieves 91% compliance in January, cutting aggregate output by 1.15 mb/d, just 190,000 b/d short of their target of 31.9 mb/d.**
- **Investors and speculators adding record bets on oil prices rising, but oil producers increasingly hedging, fearful of prices falling if OPEC cuts are not extended beyond June.**
- **OECD commercial crude and products stocks continue to decline, falling below 3 billion barrels last December for the first time in 12 months.**
- **US crude production reemerging thanks to steady shale gains; output up by 604,000 b/d (+7%) to 9.03 mb/d since July 2016.**

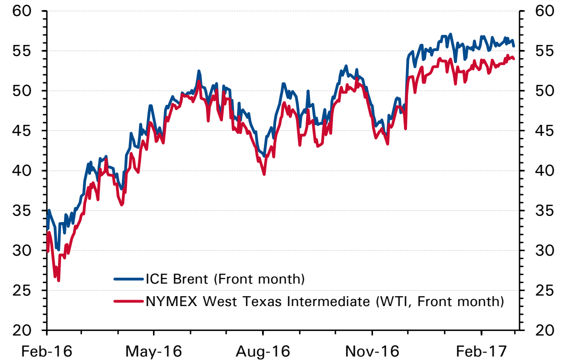
Prices range-bound for third consecutive month as the OPEC-US shale tug of war yet to fully unfold

In February, oil prices continued to trade within the narrowest range in more than a decade. Brent crude, the international benchmark and West Texas Intermediate (WTI), the US marker, remained locked within a tight $2 range around $55 per barrel (bbl) and $53/bbl, respectively, in February—much as they did during January. (Chart 1.) Neither the publication of the first set of OPEC production data in February, which confirmed a historic level of compliance by members with November's production cut agreement, nor the weekly release of data from the US showing a steady resurgence in shale production and crude stockpiles, have provided enough of a catalyst to force oil prices to break out of their comfort zones. Oil has been trading above $50/bbl ever since OPEC formalized the Algiers agreement to cut production on the 30 November 2016.

Oil investors, meanwhile, have been busy amassing record bets on the price of oil rising, heartened by the OPEC compliance rate of 91% (at the group level) and confident that the Saudi-led group will successfully unwind the 2.5-year global supply glut over the next 6-12 months. Net long positions in both Brent and WTI contracts reached record levels, advancing to 508,000 and 414,000 futures and options contracts last week, respectively. In the case of WTI, longs outnumbered shorts by nearly 9 to 1.

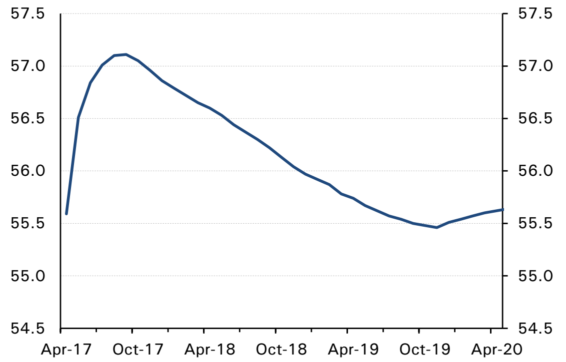
While investors and speculators have been active adding net longs, oil producers on the other hand, are increasing their net short positions and locking in hedges, seemingly worried that the OPEC agreement will not last beyond June. This is evident in the structure of the Brent futures curve, which shows prices reaching a peak of around $57/bbl by 3Q17 (contango) before falling back towards $55.5/bbl over the next two years (backwardation). (Chart 2.)

Chart 1: Crude oil prices
($/bbl)



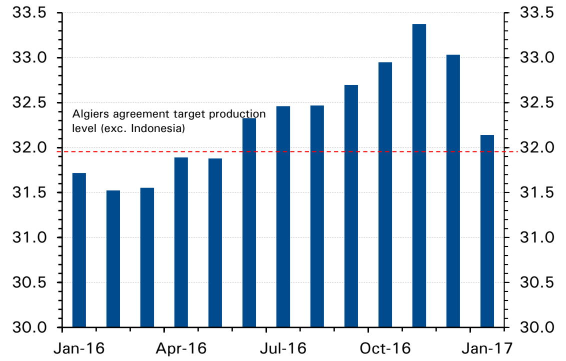
Source: Thomson Reuters Datastream

Chart 2: Brent futures curve
($/bbl)



Source: Thomson Reuters Datastream

Chart 3: OPEC crude oil production
(mb/d)



Source: OPEC secondary sources; output adjusted for Indonesia's exit

OPEC achieves historic 91% compliance with output cut pledges

As of January, the first of the 6 months in which OPEC agreed to cut crude production, aggregate output fell to 32.14 million barrels per day (mb/d), a decline of 1.15 mb/d from October's reference level according to OPEC secondary source data, the independent yardstick for assessing compliance. (Chart 3.) This leaves the group just 190,000 b/d short of the target of 31.95 (adjusted to account for Indonesia's exit from OPEC), a commendable compliance rate of 91%. Of the 10 OPEC members subject to quotas, however, only Saudi Arabia, Qatar and Angola have fully adhered to their targets; in fact Saudi Arabia went further, cutting its output by an additional 23% to 600,000 b/d. Kuwait attained 91% of its pledged output target by bringing its production down by 120,000 b/d.

Outside OPEC, only Oman complied 100% with its target. Russia, the largest contributor to the non-OPEC production cut target of 558,000 b/d, managed only 118,000 b/d, or 40%, of its 300,000 b/d production cut commitment.

OECD stocks down as oil market moves towards balance by 2Q17, but steady US shale gains likely to cap oil price rises

OECD commercial crude and products stocks began to decline during the latter half of 2016. By December, total stocks had dropped to 2.98 billion barrels, falling below 3 billion barrels for the first time in a year. (Chart 4.)

Moreover, according to the International Energy Agency (IEA), the oil market is well on its way to balancing, thanks to the OPEC output cuts. Even if OPEC/non-OPEC production were to continue at January's levels, the agency estimates that the balance of global supply and demand could move to a state of under-supply of around 0.6-0.7 mb/d during this and the next quarter at least. (Chart 5.) Global demand growth is expected to come in at 1.4 mb/d in 2017, a 200,000 b/d deceleration from 2016's 1.6 mb/d.

Having said that, headwinds are on the horizon. US shale, which has been the largest source of non-OPEC crude growth in recent years, adding about 0.6 mb/d on average to global supplies in the five years to 2014, is steadily recovering. US crude output hit 9.032 mb/d by the 24 February, a rise of 604,000 b/d, or 7.2%, since US crude production reached its nadir in July 2016, according to the US Energy Information Administration's (EIA) weekly output data. (Chart 6.)

It seems only a matter of time before the oil markets fully focus again on the reemergence of US shale as a significant supply dynamic affecting global oil balances. For the time being, the markets seem satisfied with OPEC/non-OPEC efforts to rein in excess crude supplies.

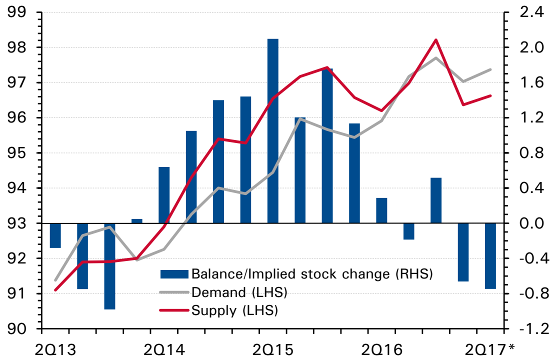
Chart 4: OECD crude and petroleum products stocks

(billion barrels)

Source: International Energy Agency (IEA)

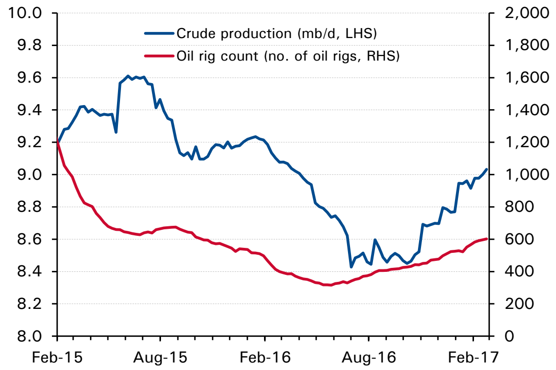
Chart 5: Balance of supply and demand

(mb/d)



Source: IEA; *forecast assumes at least 91% OPEC/non-OPEC compliance

Chart 6: US crude oil production and oil rig counts



Source: US Energy Information Administration (EIA), Baker Hughes

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