

Energy Monitor

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OPEC+ extends its production cut agreement

- ▶ **OPEC+ keeps production cut (9.7 mb/d) in place until the end of July**
- ▶ **Recent oil prices have rallied on expectations of improvements in fundamentals**
- ▶ **No reason for further price gains in the near term**

OPEC+ extends current production quota with a month

On Saturday, the OPEC plus its partners lead by Russia (together they form OPEC+) decided to extend its production cut of 9.7 million barrels per day (mb/d) until the end of July 2020. It leads to a three tiered production cut:

- 1) From now until the end of July 2020 - An extension of the production cut of 9.7 million barrels per day (mb/d)
- 2) From July until the end of 2020 - OPEC+ implement a production reduction of 7.7 mb/d
- 3) From Jan 2021 to May 2022 - A production cut of 5.8 mb/d

As such, besides the adjustment in the production quota for July, the rest of the original agreement has been re-confirmed. By extending the deeper production cut by another month, the market will reach a balance sooner, and inventories will continue to normalize. Later this month, the oil ministers of the OPEC+ coalition will decide on whether another extension will be needed. The Technical Committee of OPEC+ will monitor the market developments and the compliance of the members on a monthly base until the end of the year. The next meeting is scheduled for 30 November (OPEC) and 1 December (OPEC+).

Oil prices: a sharp recovery after a dramatic drop

USD/mmBtu



Source: Bloomberg

Prior to the meeting, Russia and Saudi Arabia had already indicated that they wanted to extend the May/June production quota by another month. But only on the condition that all participating countries will strictly adhere to the set quotas. On top of that, both countries insisted that if a country exceeded its production quota, they have to compensate the difference with an even bigger production cut in the next three months. In May, Nigeria and Iraq in particular have failed to meet their obligations. After the solemn promise to better comply with the production quotas set for both countries, the official virtual meeting was ready to take place.

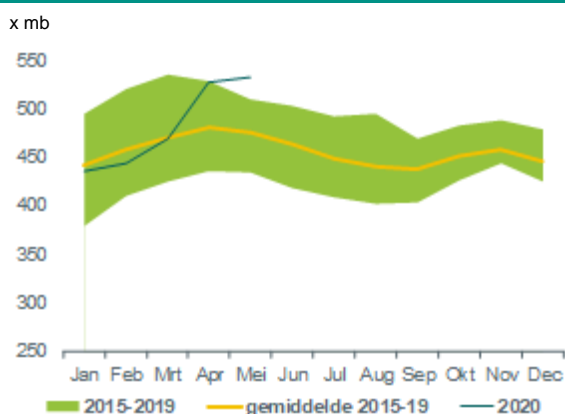
Change of strategy?

The extension by a month and its evaluation at the end of June is remarkable. This one month policy means that OPEC and its partners seem to adopt a more flexible approach of policy making. The aim is to adjust its policy on a monthly basis in order to balance the market. Until recently, they only reviewed the market situation twice a year and based their policy on that. It remains to be seen whether this is a temporary strategy to get out of this exceptional situation or whether it will take on a more structural character. Today, the markets are often driven by big data and rapidly changing market factors. Partly for this reason, a more flexible and faster approach for the OPEC (+) policy can be a good development for the oil market, for the consumer, the producer and the investor.

Stocks are still ample

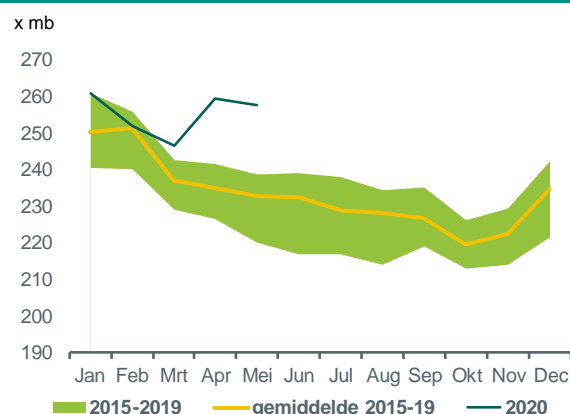
Normalizing stocks is urgently needed and one of the focus areas of OPEC+. Although demand for oil has risen and production has fallen sharply - both in the US and as a result of OPEC+'s actions - stocks are still very large. Stocks of oil products - such as petrol, diesel, kerosene, etc. - are also considerably larger than normal. There is a risk in this. After all, in case of a second wave of a COVID-19 infections break-out resulting in countries going in lockdown the demand for oil will drop sharply again. At such a moment, there is an urgent need for storage capacity to avoid a similar wave of excessive pressure on oil prices as we have seen earlier this year. OPEC+ will therefore continue to focus on - and make their policy partly based on - these stock levels. It remains a delicate balance which can easily overshoot in substantial shortages, according to Mr. Novak, the Russian energy minister.

Crude supply US



Source: Bloomberg

Gasoline supply US



Source: Bloomberg

The oil price has already shown a strong recovery

Since reaching the historic low in the WTI oil price (USD -40/bbl), oil prices have risen sharply. WTI is currently trading at USD 40/bbl and Brent has risen to USD 43/bbl. The price recovery has been driven by a combination of factors, in particular:

- Increased oil demand as a result of easing lockdowns
- Production cuts in the US
- The coordinated OPEC+ production cuts and expectations of higher future demand.

Furthermore, the number of long positions (speculating on price rises) has risen sharply in recent weeks, based on hopes that the oversupply would quickly disappear and prices would rise. Another reason for the recent support for commodity prices in general is interest by investors. Investors are looking for investment opportunities.

With ultra-low interest rates, there is more interest in commodity investments. The lack of alternatives and the fear of missing out on the price rises - and thus returns - also provide additional support. However, it is important to keep in mind that commodity markets in general, and therefore also the oil and gas market, are very specialistic, less liquid and therefore more risky markets. Large price movements are not uncommon. Investor positions have risen sharply and little is needed for profit-taking or a change in sentiment. In both cases this can lead to a large downward price correction.

Long positions increased rapidly during recent months



Source: Bloomberg

A further rise in the oil price is unlikely

With the extension of the current OPEC + production level to the end of July and the expected further relaxation of the lockdowns, the oil market appears to reach a balance in the coming weeks. Attention may then shift to a reduction in inventories. However, we think that players underestimate the risk of lower prices.

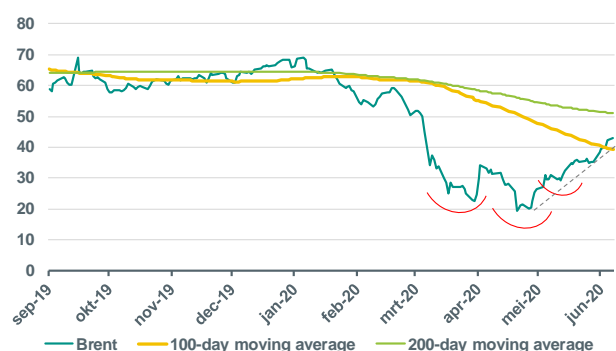
First, there is still the risk of a second wave of COVID-19 infections. That could lead to new lockdowns and a steep decline in oil demand. Second, we see the risk of low compliance by OPEC+ countries. Certainly after last week's warning, Russia and Saudi Arabia will be keen to ensure that everyone comply with the rules. If not, the entire agreement fall apart. That would be disastrous for the oil market, and with it for the oil price. Third, there is a risk of a (too) rapid recovery of US shale oil production. Scott Sheffield, the CEO of Pioneer Natural Resources (a major player in the shale oil industry), has indicated that the price of a barrel of WTI should recover to USD 40-45/bbl before production will partially resume. But with a forward curve in contango (price contract with short-term delivery lower than a contract with delivery later in time) and the first and active contract at USD 40/bbl, these price levels are relatively close. Therefore, there have been reports that the first hedges have been set up. A restart of (shale) oil production in the US could come sooner than players would have expected. For example, EOG Resources Inc. indicated to increase production again in the coming months. Nevertheless, the number of active drilling rigs has fallen further in the past week from 222 to 206.

As market expectations are usually ahead, a balance between supply and demand seems to be already anticipated. So, we think that there is little upside potential from the current level in the near term. In fact, the downside risks have increased and could come from: a) profit taking on long positions, b) disappointing economic data, c) higher production in the US and/or failure to meet production agreements by OPEC+ members, d) risk aversion in the financial market.

However, technical analysis points to a further price increase. Prices have taken out the 100-day moving average. The technical pattern that has formed is an inverted head-and-shoulder (see graph next page). So investors could continue to buy oil prices because the technical picture points to higher prices..

Technical analysis does point towards more support

USD/mmBtu



Source: Bloomberg, Michael Nabarro Tradeidee

At this point in time the fundamental outlook and the technical outlook are not in an agreement. We have a strong conviction in the fundamental outlook and therefore we overrule the more constructive technical outlook. For the time being, we therefore take into account a possible downward correction in the short term. In the second half of the year, the price may recover and rise to price levels even slightly higher than today.

Forecasts oil and gas prices

End of period		8-jun	sep-20	dec-20	mrt-21	jun-21	sep-21	dec-21	mrt-22	jun-22	sep-22	dec-22
Brent *	USD/bbl	43,09	35	45	50	45	45	50	55	55	55	55
WTI *	USD/bbl	40,15	32	40	45	42	41	45	50	50	50	50
Natural Gas (HH) *	USD/mmBtu	1,78	2,00	2,25	2,25	2,25	2,50	2,75	2,50	2,50	2,50	2,50
TTF *	EUR/MWh	12,48	14	15	15	14	15	17	18	17	18	18

Average		2019	Q3 20	Q4 20	2020	Q1 21	Q2 21	Q3 21	Q4 21	2021	Q1 22	Q2 22	2022
Brent	USD/bbl	64,17	30	40	36	48	48	45	48	48	53	55	55
WTI	USD/bbl	57,00	29	36	34	43	44	42	43	43	48	50	50
Natural Gas (HH)	USD/mmBtu	2,53	2,00	2,10	2,00	2,30	2,30	2,40	2,60	2,40	2,60	2,50	2,50
TTF	EUR/MWh	14,55	14	15	14	15	15	15	16	15	18	18	18

* Brent, WTI and Henry Hub: active month contract; TTF: next calendar year

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