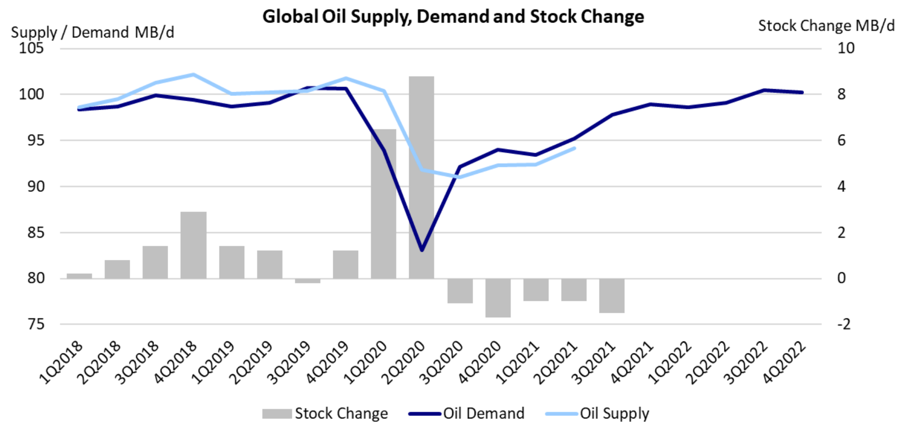
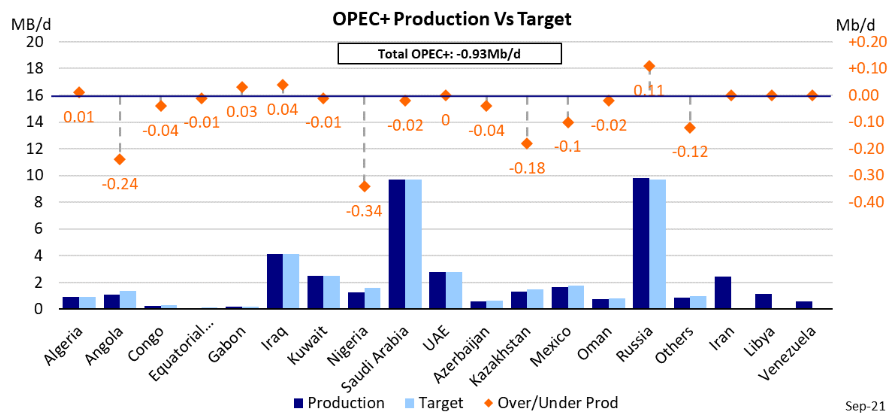
Back In Control?

OPEC+ seems to have regained its grip on the oil markets

In early 2020, the OPEC+ group was in disarray. Saudi Arabia and Russia, the leading producers of the oil exporters organization, disagreed on how to respond to the Covid-19 pandemic, which was then rapidly spreading across the globe. A brief price war broke out, which proved to be very costly for the OPEC members, and a boon for the tanker market. Shortly thereafter, realizing their mistake, OPEC circled the wagons and dramatically cut production. OPEC's production cut caused a free fall in tanker rates and earnings have been depressed since. While oil demand has picked up in line with the recovering global economy, OPEC+ has been reluctant to bring back production. The oil exporters are only slowly trickling oil back into the market and they are still producing several million barrels per day below pre-pandemic levels. This has kept crude oil tanker rates at extremely low levels. Non-OPEC (in particular U.S. shale production) has not reacted to the increase in prices and it appears that the cartel is in the drivers' seat for the moment. However, the situation may not be as comfortable as it appears on the surface.

Since Q2 2020, the oil markets have been undersupplied. This has led to five consecutive quarters of stock draws (Chart 1). The expectation is that inventories will draw down again in the fourth quarter of this year. A significant portion of the floating storage that was build up in the aftermath of the Saudi-Russian price war, has been released back into the market. Although floating storage remains higher than pre-Covid levels, about one third of the oil currently in floating storage is Iranian crude.





Source: IEA

With respect to on-land inventories, the situation is somewhat less clear. OECD stocks are down, in particular in the U.S. and Europe, where they have fallen below the 5-year average. Stock levels in the major U.S. storage hub of Cushing, Oklahoma have fallen 46% below the pre-pandemic five-year seasonal average for 2015-2019, although stocks in the rest of the U.S. (including the U.S. Gulf) appear more comfortable.

Stock levels in the other major oil consumer, China is more difficult to gauge because official statistics are hard to come by. One reliable non-government source pegged Chinese crude inventories at 977 million barrels as of October 21, which, according to them, is the lowest level since February 2020. This seems to indicate a steady decline in Chinese strategic petroleum reserves and commercial stockpiles, especially since stocks grew substantially in 2020 Q2 and Q3 as the Chinese government took advantage of the low oil prices to build inventories.

As the global economy normalizes after the pandemic, oil stock will likely need to be rebuilt and this will drive additional demand. International oil companies (especially the "majors") are facing increasing pressure to pivot from oil exploration and production towards renewables, and U.S. shale producers focus on shareholder returns rather than production growth, OPEC will be the world's swing supplier once again. However, this requires that these countries have sufficient spare capacity to manage the market. It is unclear whether that is the case at the moment.

In September 2021, OPEC+ produced 37.97 Mb/d of crude oil. This was 930,000 b/d below its official production target of 38.9 Mb/d. Many of the OPEC+ member countries produce below their quota (Chart 2). The biggest underperformers are Nigeria, Angola, and Kazakhstan. With oil prices around $80/barrel, if they are producing below target, is means that these countries are tapped out. That means also that they will not be able to participate in future increases. Iran is likely out of the picture for the foreseeable future and ongoing domestic problems in Libya and sanctions on Venezuela will keep their oil flows restricted as well. This means that Saudi Arabia and Russia will have to supply the vast majority of future increase, assisted by some other producers like the UAE. However, spare capacity in these countries may be less than expected and any major supply disruption or higher demand than anticipated could create unrest in the oil (and tanker) markets. Further price increases could lead to demand destruction and accelerate the growth of renewables.

Tanker Opinions are published by the Tanker Research & Consulting department at Poten & Partners. For feedback on this opinion, to receive this via email every week, or for information on our services and research products, please send an email to Research@poten.com. Please visit our website at www.poten.com to contact our tanker brokers.