Carry That Weight: OPEC+ Cohesion and The Conflicting Views of Russia and The Saudis

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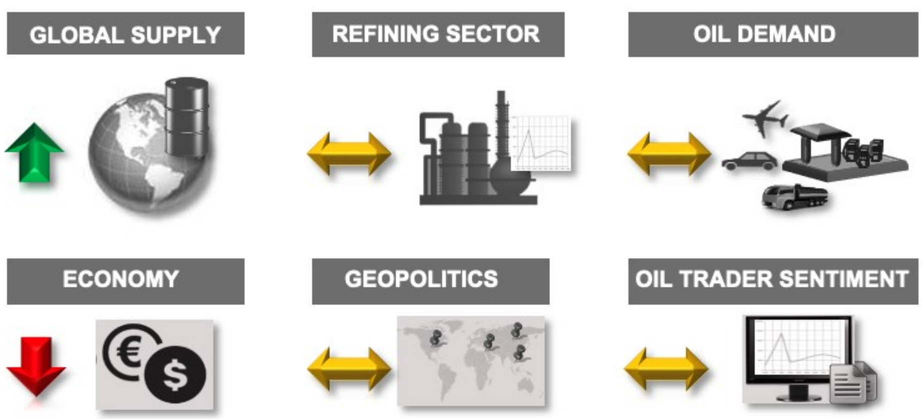
WHAT IS AFFECTING OIL PRICES THE WEEK OF October 19, 2020?



Source: Stratas Advisors

Global oil participants saw contradicting messages last week from OPEC and Russia with regards to their approach for rebalancing markets, which was reminiscent of what happened in early March, prior to the infamous meeting that resulted in a lack of an agreement and the immediate collapse of crude prices. Ultimately, the evolution of COVID-19 forced the extended cartel to reconvene by April and agree on definitive cuts, but the March 5th meeting exposed the polar-opposite positions of Russia and Saudi Arabia for dealing with market imbalances under a pandemic environment: OPEC (lead by Saudi Arabia) preferred a preemptive approach, proactively implementing production cuts to prevent a significant market imbalance, while Russia preferred a reactive approach, waiting to implement production cuts until there was there was evidence of oversupply.

Within this context, OPEC's Secretary General hinted last week that the cartel is aware that their production cuts schedule is not consistent with COVID's seasonality and the organization is closely monitoring demand with an eye on making a course correction. He hinted that OPEC would need to consider at the very least delaying the production increase scheduled for January 2021, while stressing the need for producers to "be realistic" in terms of demand expectations in the midst of upticks in global infection, seemingly preparing the ground for a potential production cuts adjustment that could be announced soon.

Almost at the same time, Russia's Energy Ministry expressed the view that the cartel would move forward with the scheduled production increases by January and mentioned he was a lot more optimistic that markets would rebalance without a need to make any changes to agreed production schedule.

If Russia does not accept delaying the January production increases and other adjustments that might be needed to align future supply with demand, it is possible that Saudi Arabia will resort to the two-fold strategy it implemented last March: adding volume to the market, as well as announcing steep price cuts to their

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monthly official prices. At this time, Saudi Arabia is not willing to carry the weight of production cuts anymore (as has been the case for many years when cuts have been needed), and Saudi Arabia will likely push Russia to align to its view by momentarily bringing crude prices down. Therefore, the possibility of a short-lived price war looms, depending upon the impact of resurging COVID-19 infections on future demand and Russia's position on the timing and extent of production adjustments.

Several other variables could still play a role in underpinning crude prices this winter, such as colder-than-usual winter that increases distillates consumption, better-than-expected demand in countries like India or China, as well as unplanned crude supply cuts, including cuts stemming from corporate layoffs and portfolio rationalizations across the world.

The oil market is entering some of the most important weeks of the year, with the upcoming US presidential election, a definitive decision -or lack thereof- of an additional economic package to support US businesses and individuals, as well as OPEC's definitive decision about crude cuts that could potentially impact oil markets and prices until 2022.

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