What's Hot: Policy meetings to drive oil's path as we close the year

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A straight-forward OPEC meeting would just be too boring for an industry accustomed to suspense and backroom dealing

There is rarely an OPEC+1 meeting without any drama. The very public spat between Saudi Arabia and Russia in 2020 that sent WTI oil prices negative for a short time still haunts the industry. As the cartel prepares for its final policy meeting for 2023, the date had been pushed out from yesterday (Sunday 26th November) to Thursday 30th of November, to give room for pre-meeting negotiations. Press sources indicate that Angola and Nigeria are angling for higher production quotas2. Both countries had their quotas cut in June 2023 after a prolonged period of under-producing. The UAE was the main beneficiary of the quota re-assignment at the time. Saudi Arabia, which has shouldered the lion’s share of production cuts this year is unhappy that other members are not pulling their weight as much. Saudi Arabia has voluntarily cut 1 million barrels per day more than the OPEC agreement calls for. And Russia (a non-OPEC ally) has agreed to a 300,000 barrel per day cut in oil exports. However, as it stands, both voluntary cuts will expire at the end of this year. Markets were hopeful that cuts will be extended into 2024. But after the announcement that the meeting was delayed, on 22nd November, Brent oil prices fell 5% intraday3 as worries mounted that OPEC+ discourse could derail the market tightness. Most of the price losses from that day have actually been recovered now. We believe that Saudi Arabia will successfully cajole other members to adhere to their quotas and take on more of the burden, because the threat of the country flooding the market with its spare capacity is too much for them to bear.

Fiscal breakevens dictate target price

We believe Saudi Arabia would like Brent equivalent oil prices of $90/bbl. That is where we estimate its ‘Fiscal Breakeven’ to be i.e. the price of oil needed to balance its government fiscal expenditures with government revenue (with a large part of Saudi Arabia’s government revenue coming from taxes and royalties on the oil industry).

Despite the bullish tone for demand expectations in OPEC’s last monthly report, we believe Saudi Arabia is worried about demand softness and market bearishness in the oil industry. Indeed, the International Energy Agency and Energy Information Administration of the US paint a much more bearish demand picture than the OPEC group. The fact that the front end of the WTI oil curve has gone into contango after 4 months of being in backwardation will clearly be on its radar. The Brent curve is still in backwardation, but the extent of backwardation has softened considerably. Saudi Arabia has previously warned short sellers that they will be punished.

Source: WisdomTree, Bloomberg. Dates: 24/11/23 and 24/10/23 Historical performance is not an indication of future performance and any investments may go down in value.

COP28 to place the oil and gas industry under the microscope

The new OPEC+ meeting date coincides with the 2023 United Nations Climate Change Conference – COP28 - hosted in Dubai, UAE. For that reason, it will be a virtual meeting rather than the physical meeting as originally planned. Hosting the meeting in a petrochemical state is designed to send a message that all nations are responsible for the global net zero targets that would be consistent with limiting temperature increases to 1.5°C above preindustrial levels. The International Energy Agency(IEA), published a thought-provoking piece just ahead of the meeting calling on the oil and gas industry to step up its role in the next zero transition. The Oil and Gas Industry in Net Zero Transitions report claims that while oil and gas demand will fall aggressively in a net zero transition path, significant oil and gas will still be required to meet energy needs and that requires decarbonisation. The oil and gas sector – which provides more than half of global energy supply and employs nearly 12 million workers worldwide – has been a marginal force at best in transitioning to a clean energy system, according to the report. Oil and gas companies currently account for just 1% of clean energy investment globally – and 60% of that comes from just four companies.

The report calls out the red herring of carbon capture utilisation and sequestration (CCUS), being the silver bullet solution to decarbonising the industry. They calculate to keep a lid on temperatures at 1.5°C, 32 billion tonnes of carbon would need to be sequestered by 2050. That would include 23 billion tonnes via direct capture. The inconceivably large amounts of electricity needed for this would be equivalent to the world's entire electricity demand today. In short, the industry needs to step up with real decarbonisation plans. There are low hanging fruits to be picked. For example, methane (a potent greenhouse gas equivalent to 6 times the strength of carbon) accounts for half of emissions from oil and gas operations. Stopping leakages and controlling natural gas overproduction could address emissions here.

Conclusions

We are entering into a week of policy meetings that will shape the oil and gas industry for both the short and long term. We expect OPEC+ to roll over and possibly increase production cuts into 2024. The oil and gas industry will be under the microscope at the COP28, based on the location of the meeting. The market and policy makers are expecting commitments from the industry, but it comes at a delicate time of softening demand expectations due to cyclical conditions.

1 Organization of the Petroleum Exporting Countries and its allies

2 https://www.reuters.com/markets/commodities/angola-focused-raising-oil-output-is-happy-opec-official-2023-11-23/

3 Source: Bloomberg, 22 November 2023

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