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Attention-attracting Conclusion at Oil Producing Countries' Meeting

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From September 26 through 28, the International Energy Forum will hold its 15th ministerial meeting in the Algerian capital of Algiers. The IEF, designed for promoting dialogue between oil producing and consuming countries, opened its first meeting in Paris in 1991 and has held a meeting every two years since the fifth meeting in 1996. The coming meeting follows the Moscow gathering in May 2014. It will be the first IEF meeting for new IEF Secretary General Dr. Sun Xiansheng, who took the post in August after serving as president of China National Petroleum Corporation (CNPC) Economics & Technology Research Institute.

The IEF meeting is attracting attention as numerous ministers and top energy company executives from oil producing and consuming counties are set to attend it to discuss the present situation and challenges for the international oil market. However, there will be a relevant event that is attracting more attention. It is an unofficial meeting of the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC oil producing countries such as Russia. Oil market players throughout the world are paying attention to whether major oil producing countries could agree on some production adjustment to address weak oil prices at the unofficial meeting.

As noted in my earlier report (A Japanese Perspective on the International Energy Landscape (285)), the unofficial meeting of oil producing countries timed to coincide with the IEF meeting in late September was announced on August 8 after the key WTI (West Texas Intermediate) crude futures price slipped below $40 per barrel. In response to the announcement, the key Brent crude futures contract rose above $50/bbl briefly within August. However, the upward momentum failed to be sustained. The Brent price has been hovering around $45/bbl since the middle of September. Behind the oil price trend is a growing view that a glut has remained in the international oil market and would take more time to be eliminated than earlier expected. According to latest data from the International Energy Agency, private sector oil inventories in the member countries of the Organization for Economic Cooperation stood at a historically high level exceeding 3.1 billion barrels in July. While oil demand is growing at a steady pace of 1.2 million barrels per day, supply is abundant with OPEC crude oil output increasing close to 33.50 million bpd in August to more than offset a production cut in non-OPEC oil producing countries.

As crude oil prices plunged substantially from more than $100/bbl, U.S. crude oil output declined year on year in 2016 even amid steady demand growth, leading non-OPEC output to turn down. As a result, the international oil market is going in the direction of rebalancing, or the elimination of the glut. Under the present supply and demand environment, however, a growing view is that rebalancing will take more time than earlier expected to delay tightening of the supply-demand balance until the second half of 2017. Therefore, the unofficial meeting of oil producing countries is attracting attention as a factor that could change the supply and demand situation and the crude oil price trend. However, most experts in the world are negative or doubtful about any impactful decision to be made at the unofficial meeting.

A fundamental reason for the dominant view among experts is that they see it as difficult for major oil producing countries to agree not only on full-fledged production cuts but also on a freeze on production increases. Major oil producing countries failed to reach any agreement on the freeze on production increases at their meeting in Doha last April before the coming meeting. Iran willing to increase oil production following the termination of Western sanctions differed with Saudi Arabia, which argued that any agreement to freeze production increases without Iran's participation would be meaningless. Five months after the Doha meeting, Iran's output has risen back to more than 3.6 million bpd close to the pre-sanction level. However, Iran has reportedly tried to boost output to more than 4 million bpd. Iran has also been ambitious to expand oil production by introducing new contracts with foreign companies from a medium-term point of view. Irrespective of whether Iran can expand oil output to 4 million bpd, market players believe that it would be difficult for Iran to accept a freeze on production increases at present.

There are some other oil producing countries that could be reluctant to accept the freeze. Libya and Nigeria have reduced production due to domestic destabilization. Given that they have the potential to expand production if their situations are stabilized, they may not be in position to easily accept the freeze. In such situation, Saudi Arabia, which has conditioned the production freeze agreement on participation by all major oil producing countries, is seen as unlikely to lead the agreement. Given its bitter experiences in the 1980s, Saudi Arabia is unlikely to accept a situation in which Saudi Arabia alone is responsible for adjusting production as other major oil producing countries fail to participate in the adjustment or refrain from adjusting production while nominally participating in the adjustment. The present oil price weakness, though causing major economic and fiscal problems in oil producing countries, has successfully prevented shale and other high-cost crude oil from expanding their global market shares, as indicated by a stop in U.S. shale oil production growth and a subsequent decline in production. In this sense, Saudi Arabia might have made no change to its stance.

Given the above, a dominant view at present is that oil producing countries are unlikely to announce an effectively significant agreement at their coming unofficial meeting. If the meeting sends a message that oil producing countries would not take any effective action even under the current supply and demand environment, downside pressure may be exerted on oil prices. At least, such message separated from other factors may be interpreted as a factor to prolong the oil price weakness. If some action regarding production adjustment is agreed on for some reasons, however, it may become a kind of surprise for the market, working to boost oil prices at least over a short term. Later, market players may focus on whether the action could be implemented and what the impact of the implementation could be like. Given the historically high OPEC production level, the impact of a simple agreement to freeze production increases could not be estimated. In this sense, we will have to closely watch the results of discussions at the unofficial meeting and later developments.

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