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Crude Special Report:

Can Opec+ surprises bring market stability?

Opec+ accepts realities with multilayered deal

Opec+ ministers have sprung another surprise with a multi-phase mega-deal that addresses short-term market concerns and long-standing internal group matters.

Ministers met in Vienna on 4 June concerned by a slowdown in major OECD economies and still sluggish economic indicators from China, but proceeded to deliver one of their most comprehensive and wide-ranging agreements of recent times. Its centrepiece is a new "voluntary" pledge by Saudi Arabia to unilaterally cut crude production by a further 1mn b/d for July, with an option to extend "if necessary". The reduction would take Saudi production just below 9mn b/d — the lowest for two years — because it is already producing 500,000 b/d below its formal 10.478mn b/d quota as part of an extra 1.16mn b/d cut with seven other Opec+ countries that runs from May to the end of 2023.

The market's reaction to the agreement, and in particular the 1mn b/d Saudi cut, was initially muted, and — in a pattern becoming depressingly familiar for Opec+ — prices subsequently dipped below pre-meeting levels. Benchmark North Sea Dated closed at just under $75.70/bl on 8 June, 25¢/bl lower than before the announcement. This evoked memories of the extra cut announcement in April, when the initially positive price impact was totally erased within three weeks. But delegates say they are not concerned — the Saudi cut was a "precautionary" move aimed at providing support and stability, they say, with the market continuing to show signs of weakness.

Opec+ additional cuts from May *mn b/d*

	Extra cuts	May target	May output	Difference to target
Algeria	-0.048	0.959	0.980	0.021
Iraq	-0.211	4.220	4.180	-0.040
Kuwait	-0.128	2.548	2.570	0.022
Saudi Arabia	-0.500	9.978	9.980	0.002
UAE	-0.144	2.875	2.900	0.025
Oman	-0.040	0.801	0.800	-0.001
Gabon	-0.008	0.169	0.190	0.021
Kazakhstan	-0.078	1.550	1.580	0.030
Total	**-1.157**	**23.100**	**23.180**	**0.080**

How long Saudi Arabia will continue this cut is an open question. Unlike the last time Riyadh embarked on a solo cut in 2021, today, it has chosen not to divulge its thinking yet. Saudi oil minister Prince Abdulaziz bin Salman says the "suspense" is "part of the storyline". "Every month we will review," he says. But what he does reiterate is that Saudi Arabia, and the Opec+ group more generally, will do not whatever it takes, but "whatever is necessary", to bring stability to the market.

Hard questions

The Saudis stole the headlines with their surprise cut, but it is the other, longer-term elements of the Opec+ agreement that are arguably more critical. Opec+ committed to extend its current production cuts to the end of next year. Formal output targets for all 19 participating countries remain unchanged for the rest of this year, but there will be changes to some countries' quotas in 2024. Those that have struggled to meet current quotas will have lower targets, while the UAE receives a higher quota to take into account the country's growing production capacity.

Eight countries will have a downward revision in quotas in 2024. Nigeria and Angola will see the biggest declines, of 362,000 b/d and 175,000 b/d, respectively. This will be partially offset by a 200,000 b/d rise in the UAE's quota, its second increase in two years after making a first push for a baseline increase in 2021.

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The net effect of these revisions is a reduction of 1.4mn b/d in the group's overall production target from January 2024. But the real impact of these changes on supply is likely to be significantly smaller. Most of those that were issued lower quotas are already producing below those levels. The Opec+ group as a whole was 3.3mn b/d under its collective target in May, *Argus* estimates.

Opec+ members have also made a fresh commitment to undergo an external assessment in 2024 to determine their production capacity and baseline production. Taken together with the baseline adjustments, the moves are long overdue and a major achievement given the political sensitivities for those having to accept a downgrade. "What we have now is an unprecedented agreement, in that it really looked back and asked the hard questions," Prince Abdulaziz says. "We will rely on independent institutions to verify capacities, and make sure this whole process will be first and foremost technical and independent of our own claims."

Necessary cut?

Saudi oil minister Prince Abdulaziz bin Salman likes to surprise the oil market. True to form, he unveiled an unexpected 1mn b/d unilateral output cut by Saudi Arabia for next month at the press conference after the Opec+ ministerial meeting in Vienna on 4 June. But he is also deadly serious. "This is not a toy, this is not a joke," he says. "This is a market that needs stabilisation."

Saudi Arabia is the dominant force within Opec and Opec+, wielding market power with its large spare capacity reserve. But Riyadh is now pursuing its own agenda outside the cosy umbrella of collective action. Only one of the triple package of measures announced by the Saudi minister was formally ratified by the Opec+ ministerial meeting. The rest were "voluntary" actions by Saudi Arabia alone or in concert with a smaller group of producers.

At this month's meeting, as widely expected, Opec+ extended its output agreement to the end of next year. But more importantly, members agreed to adjust national production baselines for 2024 to be more in line with actual capacities. Prince Abdulaziz insists that transparency is important to him. "It is my responsibility," he says. Opec+ has persistently failed to achieve agreed output targets because some members struggle to meet quotas, which explains the 1.4mn b/d drop in next year's group target.

Solidarity is also important for Opec+ ministers determined to preserve co-operation between Opec and its non-Opec allies. Yet underlying tensions were evident during the press conference. "We are united when it comes to the aim of market stability," UAE oil minister Suhail al-Mazrouei says. The UAE in April joined Saudi Arabia and six other Opec+ producers in announcing 1.2mn b/d of unexpected extra cuts. But with UAE output well under its 4.2mn b/d capacity, a new deal had to address "fairness" as well as "the requirements of the market". Hence the UAE gets an increase in its quota from next year to recognise the country's capacity expansions.

The rest of Opec+ is unable or unwilling to take further action to "stabilise" oil prices, so Saudi Arabia sees no option but to go it alone. Prince Abdulaziz is adamant that "precautionary" action is essential. "We will do whatever is necessary to bring stability to this market," he says. But he is more concerned about uncertainty than price. "We are not targeting prices," he says. "We do not like short-term volatility. We do not like mid-term volatility. And, certainly, we do not like long term. We are hedging. But we are using the fundamentals to hedge. And we will continue to hedge as long as we do not see clarity and stability."

Saudi Arabia is under growing pressure from cheaper Russian crude in its key Asia-Pacific markets. Nearly half of India's imports last month were Russian crude. And China's expected post-lockdown recovery is stuttering. But Riyadh is not willing to start a price war to recover lost market share in Asia or boost sales to the Atlantic basin.

Prince Abdulaziz has not explained the reasons for nor the timing of Saudi Arabia's actions. "We look at the contours," he says. "It is not wrong to be wrong, because that is the nature of things, things change." Only time will tell whether his extra 1mn b/d reduction was a necessary cut. Either way, it is clear Saudi Arabia will play a more active – and a more independent – role in the oil market in future.

Saudi cuts tighten Asian market

Asia-Pacific refiners are bracing for tighter crude supplies next month following Saudi Arabia's decision to reduce its output by a further 1mn b/d in July, with the option to extend, on top of the 500,000 b/d output cut it pledged in April.

Following the announcement of the additional cut at the 4 June Opec+ meeting, Saudi Aramco raised the official formula prices of all its July-loading crude exports to Asia-Pacific by 45¢/bl, defying expectations that it would reduce its prices in light of lower crude demand in the region. The surprise increase could be one way for Aramco to deter term buyers from requesting the maximum loadings allowed in their contracts, allowing the producer to meet its cut obligations. Asia-Pacific refiners are mulling their nominations for July-loading Saudi crude, with some, mainly in China, likely to request lower amounts because of the hikes to formula prices. Chinese refiners requested lower volumes of June-loading crude from Saudi Arabia last month, according to *Argus* surveys.

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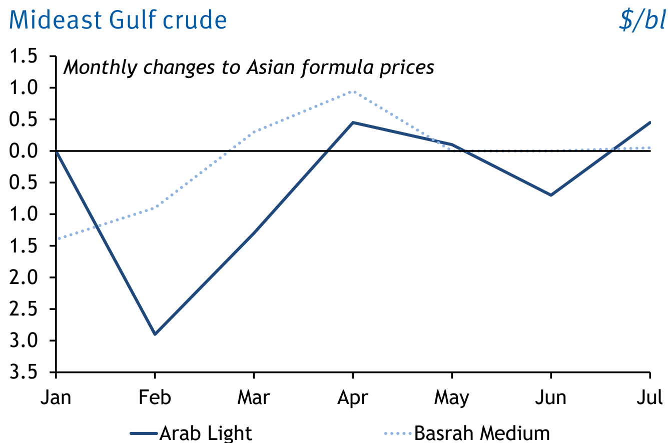


But despite the higher formula prices, other refiners, particularly in Japan and southeast Asia, may still request their usual monthly crude volumes from Aramco for July loading, traders say. This is because of limited unsold spot crude in the market, leaving some refiners reluctant to reduce term loadings. Aramco and most other Mideast Gulf producers tend to allocate term crude a month ahead, while trade for spot crude is usually for cargoes loading two months ahead. The trade cycle for August-loading Mideast Gulf spot crude cargoes has begun, and apart from arbitrage grades from west Africa that may still be seeking outlets, or some leftover July-loading Oman crude cargoes from the previous trading cycle, the availability of July-loading spot cargoes is sparse unless refiners, namely those in China and India, are willing to lift Russian crude.

Steeper market

If refiners do request lower term Saudi crude supplies or if Aramco allocates below nominated volumes, there could be a surge in demand for August-loading spot crude as buyers try to fill the supply gap, which could drive up spot cargo differentials. And there are already indications that the August-loading Mideast Gulf spot market could strengthen.

The backwardation in medium sour Mideast Gulf benchmark Dubai crude, or the premium of front-month August Dubai to the third-month October contract, widened to $0.91-1.08/bl on 6-7 June, the firmest premium since 15 May. Steeper Dubai backwardation indicates a stronger medium sour crude market. Dubai is also stronger as the heavier Saudi grades — Arab Medium and Arab Heavy — have been the first to be cut whenever the country has reduced output. But with Arab Heavy supplies tight, market participants say Aramco may have to reduce exports of its flagship medium sour Arab Light to meet its lower output target.

Chinese refiner Rongsheng emerged earlier than usual this month and bought around 2mn bl of medium sour Oman crude and 6mn bl of medium sour Abu Dhabi Upper Zakum crude for August loading in a spot tender on 6 June. In the previous two months, Rongsheng emerged only mid-month to issue tenders to buy but may have wanted to secure cargoes quickly this month in case of a rise in spot prices. In another striking move, state-owned QatarEnergy (QE) has set the official formula price for its July-loading medium sour Qatar Marine above that for light sour Qatar Land. This is the first time since October 2021 that QE has set Qatar Marine above Qatar Land and was probably in anticipation of a stronger medium sour market because of lower supplies of medium and heavy Saudi crude.

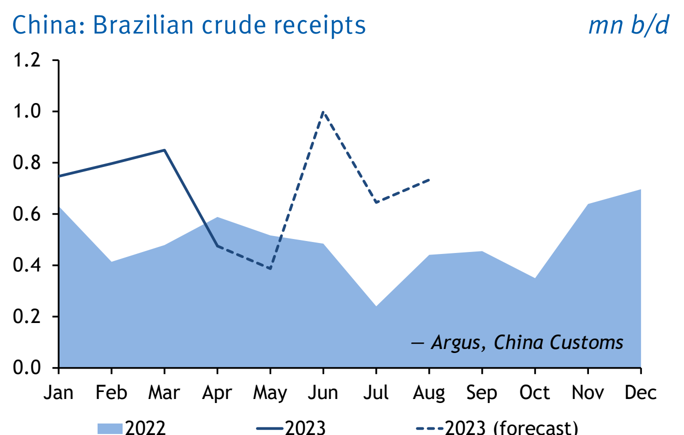
China seeks alternatives after Saudi cut

Saudi Arabia's unexpected 1mn b/d unilateral output cut next month will tighten sour crude supplies, encouraging Chinese buyers to look at sweet alternatives.

Saudi Arabia now aims to produce 9mn b/d in July, down from 10.5mn b/d in April. It is likely to invoke term contract reductions to do so. It is also hiking differentials in its official formula prices to discourage demand from marginal buyers in Asia-Pacific and elsewhere. This comes as China's key sweet crude suppliers, Angola and Brazil, are increasing output. West African loadings are due to hit 3.32mn b/d in July, up from 2.96mn b/d in June. Brazil is expected to ship more crude when a windfall tax on exports expires at the end of this month.

News of the extra Saudi cut helped push Mideast Gulf sour benchmark Dubai prices more than $4.60/bl higher in the four trading days after the 4 June Opec+ meeting. But the impact in the Atlantic basin was much less pronounced. Benchmark North Sea Dated fell by 25¢/bl over the same period. Backwardation — prompt premiums to forward values — also steepened more in the east of Suez market. Prompt Dubai swaps rose by nearly 40¢/bl more than the three-month contract, while the equivalent North Sea forward market inter-month spread contracted by 20¢/bl.

Many of China's macroeconomic indicators suggest that its post-lockdown recovery is running out of puff, but refiners are buying cargoes arriving in August that they will process



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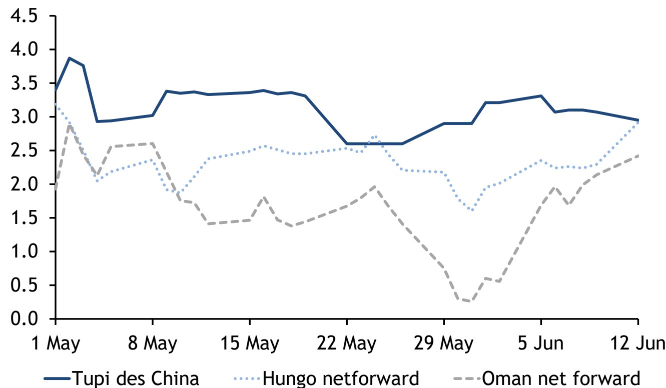

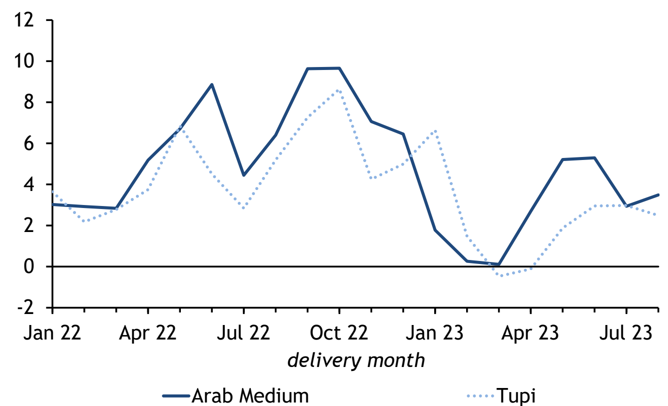

in September. This is typically one of the strongest months for Chinese oil demand. Buyers have already taken 740,000 b/d of Brazilian crude from the trade cycle for August-arriving cargoes, which got under way around 22 May (*see graph p3*).

The Brazilian trade cycle begins around 10 days before those of west African producers, giving Chinese buyers two working weeks to secure Brazilian supply before considering comparable west African crudes. This tends to pressure the market for Angolan grades such as Hungo at the start of each new trade cycle in the absence of strong demand from Europe.

West African revival

But the resulting downward pressure on west African spot differentials appears to be reigniting the appeal. Hungo's discount to key Brazilian grade Tupi has widened by 30¢/bl in the Chinese delivered market since trade in August-arriving Brazilian crude got under way, spurring an acceleration in demand for west African exports (*see graph above*). Nearly all July-loading Congolese Djeno cargoes have traded to China and only a quarter of Angola's July programme remains unsold.

Unipec has bought at least two spot cargoes of July-loading Djeno this month at discounts of $1.50-2/bl to North Sea Dated, up to 65¢/bl wider than values in the preceding three weeks. Two more cargoes have been allocated to Unipec on a term basis, totalling nearly half of the grade's July programme.

Saudi Aramco's formula price increases suggest that Saudi grades are — in Ice Brent equivalent terms — pricier than August Tupi and that China may request less Saudi crude (*see graph above*). It is unclear whether China's other Mideast Gulf term suppliers will follow suit. Iraq and Kuwait are not cutting output. Dubai backwardation, which typically sets the direction of regional formula pricing, flattened between April and May, suggesting that they could actually lower prices.

Sour crude spot differentials are certainly now out of step with Saudi prices. Oman has become far cheaper than Tupi or US medium sour Mars since late April, while UAE light sour Murban is competitive with US light sweet WTI. Private-sector Rongsheng bought August-loading Oman Export Blend and UAE grade Upper Zakum in the latest spot tender for its 800,000 b/d ZPC refinery.

Saudi surprises extend to foreign policy

Saudi Arabia's capacity to surprise has not been confined to oil markets – Riyadh has also of late delivered some remarkable turnarounds in its foreign policy. The recklessness of Saudi Crown Prince and de facto ruler Mohammad bin Salman's early adventurism in Yemen's civil war, and in the Saudi-led embargo on Qatar, is long gone. The surprise now is perhaps over how far Riyadh is prepared to go in support of regional rapprochement.

Saudi peace efforts with Yemen's Houthi group were spurred by its vulnerability to destabilising attacks on vital oil assets and threats to its wider economic interests. But its Yemen peace overtures have almost been overshadowed this year by Riyadh's move towards detente with regional arch-rival Iran, in a historic deal brokered by China. Soothing regional tensions extended to welcoming Tehran's ally Syrian president Bashar Assad back into the Arab League last month. And Riyadh even trumped the symbolism of that rapprochement by also hosting Ukrainian president Volodymyr Zelenskiy at the same gathering.

Beijing was able to act as an honest broker in thawing Saudi-Iranian relations, its neutrality built upon the strength of its commercial ties with two of its leading oil suppliers. Saudi Arabia's projection of neutrality in the Ukraine war has been made suspect for some by its close relations with Russia, as joint leaders of the Opec+ producer alliance. Production cuts announced by the group in October marked a new low point in relations between Riyadh and the US.

But this month's announcement of a new Saudi production cut elicited barely a response from the White House. Instead, US secretary of state Tony Blinken's visit to Riyadh focused on

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Saudi Arabia's constructive role in Yemen and Sudan peace efforts, and in the wider recalibration of regional relations. Riyadh says it applies the same approach to balancing tighter economic relations with China and a key security relationship with the US. "We are all capable of having multiple partnerships and multiple engagements," Saudi foreign minister Prince Faisal bin Farhan al-Saud says.

The latest multilayered Opec+ deal almost mirrors that strategy. A higher 2024 quota for the UAE accommodates the growing market power of Riyadh's Gulf neighbour. Lower 2024 quotas for those already in capacity decline aim to enhance Opec+ claims for longer-term credibility. And Saudi Arabia's cut reflects the tricky balancing act it faces with Russia within Opec+. Sanctions on Russian oil have bifurcated the global oil market, with discounted Russian supply heightening competition with Saudi Arabia in its key Asian growth markets. Unilateral action by Saudi Arabia may benefit Russia more for now, but their mutual interest in defending oil revenues means that Riyadh is unwilling to start a price war with Moscow to recover lost market share. It might still sound like a contradiction in terms, but Saudi surprises, for now, really do appear to be all about stability.

UAE boost sweetens Saudi relations

The 4 June Opec+ decision to grant the UAE a higher level of production from 2024 reflects the sometimes overlooked ability of Saudi Arabia and the UAE to compartmentalise their growing differences.

Saudi Arabia's energy minister, Prince Abdulaziz bin Salman, and his UAE counterpart Suhail al-Mazrouei exited Opec's Vienna secretariat hand-in-hand on 3 June, a day ahead of the Opec+ ministerial gathering, a gesture that set the scene for the ensuing decision. A discussion at the top level had taken place prior to the 3-4 June meeting regarding the UAE's production level within the coalition, a source with knowledge of the matter informed *Argus*. The UAE has been producing well below its now 4.2mn b/d capacity — it plans to expand capacity to 5mn b/d by 2027, or even earlier.

The door was opened ahead of the meeting for a conversation on quotas and a new deal with new baselines that are more in line with the realities on the ground as Opec+ looked to discuss what happens beyond 2023, when its October 2022 production cut agreement ends. The UAE previously secured a revision of its production baseline in July 2021. Riyadh, meanwhile, understood the need for sweeteners to push through a deal. More "fairness" in terms of production baselines was one, including Saudi flexibility to accommodate the UAE's demands.

Opec+ revised the UAE's production quota for 2024 up to 3.219mn b/d, from the 3.019mn b/d agreed under its October 2022 agreement. The UAE is producing 2.875mn b/d under a pledge to cut an extra volume of 2023 output from May.

But away from Opec's Vienna headquarters, Abu Dhabi and Riyadh face strategic divergences on several fronts. The Saudi quest to overhaul and diversify its economy by moving away from dependency on oil revenues has created regional competition for foreign investment. The Saudi decision to push foreign companies to move their regional headquarters to the kingdom was seen as a challenge to Dubai, which is the UAE's international financial and business hub.

Geopolitically, the neighbours have a diverging view on the war in Yemen, where their interests are not aligned, a regional diplomatic source tells *Argus*. Riyadh is unilaterally pursuing peace talks with Yemen's Houthis as part both of a push to end the nine-year war and a wider effort for detente with Iran.

Summit's up

Other diplomatic clues lend credence to what appears to be a cooling of relations between the countries' leaderships. The absence of UAE president Mohammed bin Zayed al-Nahyan from recent major summits hosted by Saudi Arabia was notable. Al-Nahyan did not travel to Jeddah to attend May's Arab League summit, nor to Riyadh last December for a historic China-Arab states summit hosting Chinese president Xi Jinping. Meanwhile, Saudi Crown Prince and de factor ruler Mohammad bin Salman was absent from Abu Dhabi's summit in March, which hosted the rulers of Jordan, Egypt, Qatar, Oman and Bahrain.

The outcome of the Vienna meeting and the display of fraternal goodwill between the two Gulf heavyweights, however, could have a spillover effect. "Relations [between Saudi Arabia and the UAE] are strategic and any two countries sometimes pass through rough patches," the diplomatic source says. But with Opec+ becoming increasingly dominated by its key producers, expectations will mount as well. Abu Dhabi's rising crude capacity is likely to maintain its pressure for a longer-term rise in its quota. "The UAE will always support this group and we will always stay together," al-Mazrouei told the Opec+ meeting's press conference, "and I think… we will be elaborating more in the future toward a more transparent and fair way of looking [at things]."

For more information:

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