Energy Intelligence

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Opec-Plus Builds Market Leverage

Opec-plus' decision to cut oil supply despite deep uncertainty over Russian exports was designed to arrest recent price declines and assert market leverage, pushing back against rising consumer intervention, according to our analysis.

■ **Opec-plus agreed a surprisingly long cut, but hinted at flexibility.** Opec-plus agreed to cut 2 million b/d from August quotas through December 2023, with physical cuts closer to 1 million b/d given persistent underproduction (Opec-plus produced ~3.6 million b/d below its August target, our estimates show). But Opec-plus officials have hinted at potential adjustments; the group will review market conditions on Dec. 4 and twice annually thereafter (vs. monthly now), barring emergency talks. We believe a partial, but not full, reversal could be considered Dec. 4 if markets are tight. Washington's sharp reaction could steer some in favor of easing cuts, although continued US Strategic Petroleum Reserve (SPR) releases would make the group more resistant. Early signs are that Russia could show flexibility, although the meeting's timing — the day before EU sanctions and the G7 price cap on Russian crude take effect — makes Moscow's position hard to predict.

■ **The cut asserts greater market leverage while challenging consumer intervention.** Officially, the decision was a technically-driven preemptive move to limit downside price risk amid heightened recession concerns. A cut would also rebuild spare capacity ahead of sanctions-related supply disruptions. Our calculations see Opec-plus spare capacity rising to 3.1 million b/d in November, from 2.4 million b/d. We see restoration of this cushion — and resulting Opec-plus leverage — as a primary driver, as the group asserts itself against rising consumer intervention, including SPR releases, Russian sanctions and the price cap. We also see a strong geopolitical context, including: (1) Saudi Arabia's prioritization of preserving Opec-plus, (2) Moscow's broader use of energy as leverage against the West, and (3) the ongoing producer-consumer struggle over energy policy direction.

■ **Washington is weighing options, but likely to hold fire until after elections.** The sharp escalation in US rhetoric toward Saudi Arabia following the cut underscores a years-long cooling of relations, with tensions including the war in Yemen, murder of Jamal Khashoggi and lackluster US response to missile/drone attacks. After some blunt public sparring, both sides appear to have pulled back. US President Joe Biden is still expected to take some action, but likely after November midterms – with rash actions unlikely. Options for Biden and Congress include: (1) SPR releases beyond announced volumes, (2) passing "Nopec" legislation exposing producing countries to US antitrust laws, (3) halting or pausing Saudi arms sales, (4) more actively promoting US oil production, (5) restricting US oil exports, and (6) expedited resolution of Venezuelan or Iranian sanctions.

■ **US actions will avoid Saudi Arabia's biggest pressure points.** The Biden administration has signaled additional SPR releases as likely, but Riyadh's biggest fears (retreat of US troops, lifting of Iranian sanctions) remain least likely. Further SPR releases will be reviewed in a month, for supplies in January, with a decision guided by prices (more likely at $90+). Odds of Nopec legislation passing have risen and would be hard for Biden to veto, despite the potential threat of retaliation. A temporary hold on arms sales to signal disapproval is possible. But any more permanent breakdown in security ties would have consequences for the US, in regional interests, anti-terrorism and containment of Iran — and we see little concern among Saudi officials. Talk of easing sanctions on Venezuela remains contingent on political progress — unlikely, and with minimal volumes in play. Oil sanctions relief on Iran is even less likely, in our view.

■ **The cut will keep markets tight, especially with a Russia disruption.** The Opec-plus cut will essentially keep inventories flat over the next three quarters, keeping markets tight amid extreme uncertainty, particularly around Russian supplies. Our balances now indicate a 1.1 million b/d stockdraw in Q4, largely offset by a (reduced) 600,000 b/d surplus in H1'23. We see weaker demand growth of 1.8 million b/d this year (down 400,000 b/d from previous estimates) and 1.6 million b/d in 2023 (down 500,000 b/d). Economic turbulence, China's zero-Covid-19 policy and global virus variants, mild winter weather, and restrictive energy costs present further downside demand risk. Conversely, EU bans on Russian imports and G7 price caps offer unprecedented supply challenges. Our base case assumes Russian crude and refined product flows fall by 600,000 b/d each next year, but a deeper halt — deliberate or otherwise — is possible. We are maintaining our Brent forecast of $95 for Q4'22 and $105 for Q1'23, for now. But any unwillingness by Opec-plus to respond to supply outages raises the prospect of $100+ Brent arriving sooner.

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