

OPEC Production and the Tanker Market



A decision by OPEC to cap or cut output has been increasing in likelihood across the course of this year. The announcement shouldn't come as a major shock, nor do the parameters of the revised objective mark a huge deviation from the status quo. The target range for output has been set between 32.5 – 33.0 Mn b/d which implies at most a 0.7-1.0 Mn b/d cut from estimated August volumes but could equally result in a drop of just 0.2 Mn b/d – close to the typical monthly fluctuation seen in OPEC crude volumes.

As such this move should be viewed more as an output cap as opposed to a substantial cut. The range it is targeting is similar to levels seen across the first half of 2016. Compared with OPEC's c. 3.5 Mn b/d cut in crude production seen between Q3 2008 and Q1 2009 in the wake of the financial crisis it barely registers. The lack of detail on allocation, and clearly strained negotiations taken to reach such a decision have the potential to further dilute its impact.

The symbolism of the move is more significant than its initial extent though. It is OPEC's first attempt to cut output and manage prices since 2008. It also marks

a turning point from OPEC's laissez-faire attitude to production and pricing, established at the end of 2014 as oil prices plummeted. That decision (or lack thereof) had a major effect on both crude prices and tanker earnings, and should stand as a challenge to some commentators' claims that OPEC's actions have a diminished influence on the tanker market, be it positive or negative.

It reinforces MSI's view that there are structural demand-side risks to tanker market fundamentals, and taken at face value should be viewed as a negative development for tanker freight rates. Any upward pressure on oil prices, lower trade volumes and deterrence of price-sensitive crude buyers can't be viewed in a positive light.

Whether the group of producers can follow through on this initial step and will then act further remains a clear source of uncertainty though. OPEC's track record on production quota discipline is not strong. A scenario detailing the effects on the tanker market of a sustained cap on seaborne oil trade growth is provided in MSI's latest quarterly tanker market report.