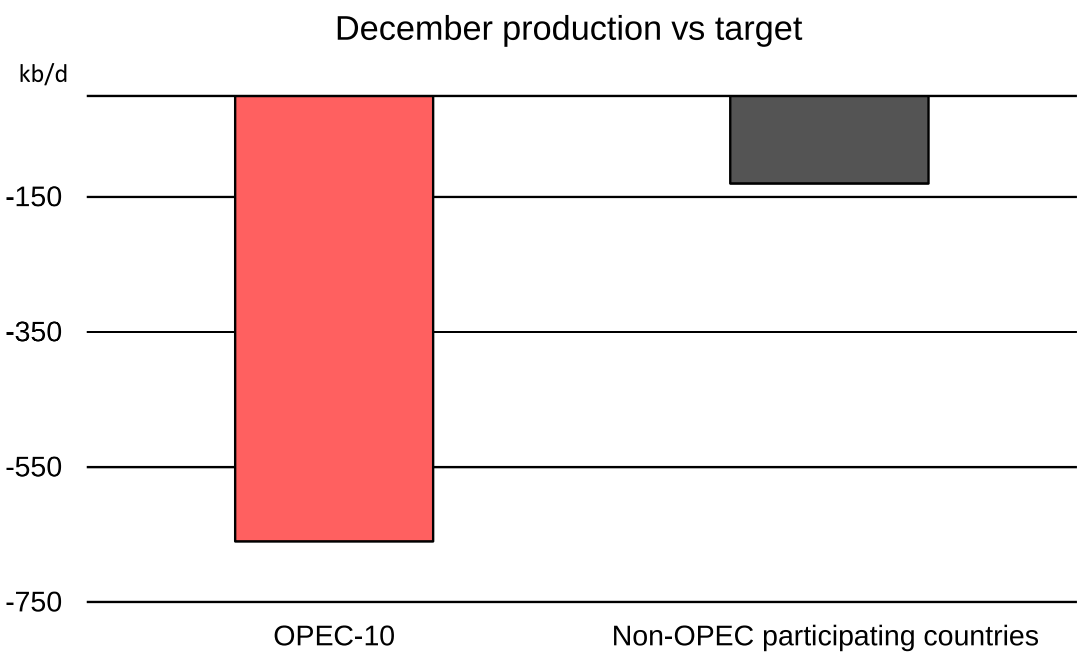
Missing barrels: Why the oil market is tighter than it should be



Source: IEA, UniCredit Research

- Tomorrow, in its regular monthly review meeting, OPEC+ will announce its production decision for next month.* With Brent prices hovering around the critical threshold of USD 90/bbl, beyond which demand risks being impaired, the cartel might decide to accelerate the tapering of its output cuts and hike production by more than 400kb/d in March. The move would aim to satisfy buoyant demand and mitigate the spillover effects from Russia-Ukraine tensions on oil prices. What might prevent OPEC+ from pushing for more ambitious targets is that some members are already struggling with existing quotas. This is why we expect OPEC+ to continue with the plan to raise the production target by 400kb/d for next month.

- Our *Chart of the Week* shows that the oil market is tighter than it would be if there were full compliance with production targets. In December, actual OPEC+ production was 790kb/d below target – that is the equivalent of two months without increasing production. Or, to put it differently, it is as if the cartel had paused its tapering of output cuts in both November and December. The missing barrels amount to almost 1% of pre-pandemic global oil production. The two main contributors to the shortfall are Nigeria (450kb/d below target) and Angola (250kb/d below quota). These countries are running out of spare capacity after years of underinvestment (Nigeria's pipelines are leaking and Angola's deep-water fields are in decline) – something that cannot be reversed quickly. Nigeria's December target was 10% above its sustainable capacity (production that can be activated within 90 days and sustained for a prolonged period of time), and Angola's target is almost 18% more than what it can sustainably produce. The situation could also worsen for other countries. By the end of the year, Russia should be producing 11mb/d but its capacity is just 10.6mb/d.

- An approach that would positively surprise markets and rein in prices would be if the cartel were to decide to assign quotas based on actual spare capacity rather than just announcing production hikes that cannot be achieved. Overall, OPEC+ sustainable capacity amounts to 4.9mb/d, more than enough to satisfy the 3.3mb/d of demand growth expected in 2022, even without a boost in US production. The problem is that the spare capacity is not evenly distributed within the cartel. Almost 45% belongs to Saudi Arabia and around 25% to the

UAE. Therefore, any quota redistribution based on actual capacity would likely be a source of diplomatic tensions as the other members of the group would fear losing market share to these two producers.

* OPEC-10 excludes Libya, Iran, Venezuela and Mexico that are exempted from the output cuts. The non-OPEC portion of OPEC+ includes Russia, Kazakhstan, Oman, Azerbaijan, Malaysia, Bahrain, South Sudan, Brunei, and Sudan.

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