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Where's the barrel going? From Riyadh to the Russian enigma, here's what fund managers and analysts have to say

By **Igor Pakovic**

The long (but warily) awaited agreement has at last arrived. During the Vienna meeting, the member countries of the Organisation of the Petroleum Exporting Countries (OPEC) managed to find common ground on reducing their oil production quotas.

OPEC members will need to cut total production by 1.2 million barrels a day. That corresponds to 4.5% of overall production, not counting Libya and Nigeria, the two countries exempted from the deal.

Now, however, the ball is in the court of non-member countries. OPEC has formally asked them to contribute by cutting 600,000 barrels a day. Russia has apparently promised to a reduction of 300,000 barrels, but it's not yet clear if it will take on the full burden and cut the other 300,000.

Outside the cartel

"They've followed the example of the central banks. By including Russia in the negotiations, they've shown that they want to coordinate with countries outside the cartel, just like the central banks did after the financial crisis". That's the explanation given by Bob Minter, investment strategist at Aberdeen Asset Management.

In absolute terms, Saudi Arabia (486,000 barrels a day), the Gulf states (300,000) and, after an exhausting tug of war, Iraq (210,000) are the members who will make the biggest cuts in their production targets. The big question mark on the eve of the meeting in Austria that cast shadows over its potential success was the relationship between Riyadh and Teheran.

Iran eventually agreed to cut its production from 3.9 million to 3.7 barrels a day but once the figures had been added up this turned out to be a reduction on paper only. For all the other member countries, with the exception of Angola, the "current" production quota (3.9 million) corresponds to the October level. But in Iran's case it actually corresponds to the highest output in the pre-sanctions year of 2005. According to analysts, Teheran's current production levels are lower, which means that with the Vienna agreement Iran has actually been given the green light to increase its production.

Promises kept?

It remains to be seen whether the OPEC members and non-members will keep their promises to cooperate. To prevent the traditional double dealing of all participants, after more than 10 years of confidentiality the organisation has decided to publish each country's production quota – in the case of Iraq that hasn't happened since 1998 – and rely on a monitoring committee that oversees the implementation of the cuts, both by OPEC members and by countries outside the cartel.

"This time, with Iran increasing production, the spotlight is on the Saudis, which have agreed to take on the biggest cut, and on Russia, which historically has never implemented cuts in production and has maximised profits", comments Angelo Meda, Head of Equities at Banor SIM.

Nitesh Shah, Director and Commodity Strategist at ETF Securities, points out that with the self-suspension of Indonesia, which produces 0.7 million barrels a day but will be leaving the organisation, the total reduction amounts to 0.5 million barrels a day. "On the basis of this announcement, we think the market will find its own equilibrium in the second half of 2017. And if we look beyond the initial euphoria, to see a lasting increase in the price of crude oil we'll need to wait until the production cuts really take effect and are not just the usual empty rhetoric we've observed so often in the past".

On the edge of a razor

In Shah's view, OPEC is balancing on the edge of a razor. Depending on cooperation by non-OPEC countries, the agreement – which will last six months and could be extended for another six if the markets take a positive view – could collapse if they don't keep their part of the bargain. That said, Moscow, along with Riyadh, is the economy that would have most to gain from a definitive rise in the price of crude.

And what's happening now? "In the short term, until mid-2017, the agreement has prevented a situation of over-capacity that would have depressed prices even more, as has been the case since Q3 of 2015, with supply higher than demand and stocks continuing to grow", explains Meda.

In spite of the cut, continues Banor's portfolio manager, it's important to remain cautious with respect to the oil price. That's because, "especially after the election of Trump, who has announced he wants to remove the bottlenecks in the US system by maximising production", American production should resume growth.

The main message that Aberdeen Asset Management's Bob Minter would like to send out to OPEC is a political one. "Many observers had begun to doubt OPEC's ability to react to movements in the oil market and this agreement reaffirms their ability to act as a group". That's especially true now, concludes Minter, with the clouds of an existential threat appearing on the horizon in the form of China and India's determination to feed their taste for black gold.