Prices tumble but OPEC/non-OPEC oil producers seek to maintain grip on fundamentals

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•Market sells off after OPEC teased longer, deeper cuts
•Ministers say not to read into lack of exit strategy
•Dismiss bullish projections for US shale growth

Key oil producers led by OPEC sought to reassure a skeptical market Thursday after announcing a gentler extension of their output cut agreement than they had earlier teased, while downplaying the boon-canceling potential of their free-market rivals, especially US shale.

Together controlling just more than half the world's oil output, the producer coalition composed of an expanded OPEC -- with Equatorial Guinea joining its ranks -- and 10 non-OPEC partners including Russia rolled over a 1.8 million b/d production cut agreement into March 2018.

Militancy-wracked Libya and Nigeria, both of whose oil prospects appear to have improved in recent weeks, will remain exempt from the cuts, which amount to just 2% of global oil demand. Iran, which was allowed a slight increase in production as it recovers from western sanctions on its oil sector, also will maintain its quota level under the deal.

Various ministers and delegates throughout the week had hinted that an extension of the cuts could include deeper output reductions or as long as a 12-month agreement.

But after reviewing various proposals, the producers settled on their nine-month deal, sending oil prices tumbling. The rumored participation of Turkmenistan, Egypt and other producers also failed to materialize.

"At a point in 2018, it is likely that those small reductions in output will no longer lead to a greater improvement in [producer] revenues because of other supply and demand offsets," analysts with Barclays said in a note. "Even if the curve moves to steep backwardation, producers will still hedge more output, and this will have ramifications for the supply and demand balance for the rest of 2018."

NO EXIT STRATEGY

The fact that the agreement included no explicit exit strategy on how cuts might be gently phased out apparently also spooked traders who feared a quick reversion to OPEC's bruising market share battle that helped precipitate the current oversupply.

But the lack of such language in the deal "should not be interpreted that we do not have a strategy," Saudi energy minister Khalid al-Falih said at a press briefing as ICE Brent July futures hit an intraday low of $51.32/b.

A five-country monitoring committee composed of representatives from Kuwait, Russia, Venezuela, Algeria and Oman, will meet monthly to assess market conditions and review compliance. That committee is empowered to recommend a further extension beyond nine months "or other interventions, if needed," Falih said.

"The plan now is to stay steady and go through the nine months and monitor," he said.

Russian energy minister Alexander Novak said mechanisms for ending the agreement were discussed, but the group "agreed that there is no reason to speak about it now."

"We can always discuss this if needed," he said.

Iraqi oil minister Jabbar al-Luaibi was likewise sanguine about the end of the deal and said that Iraq would not "flood the market with oil" when the agreement expires.

"We are not going to make trouble with the market," he said. "We are going to see things in a wise way. We will keep the balance and the prices of the market. That is the fundamental policy of Iraq."

While the deal nominally is a nine-month extension of cuts that had been set to end in June, it will be reviewed at OPEC's next biannual meeting, November 30, where the 10 non-OPEC participants will also be invited.

That makes it in practical terms a six-month deal, as Falih said a decision would be made at that meeting on "what to do in the first quarter and beyond."

He added that he was not preoccupied by the day-to-day price gyrations of the market.

"Price is not the indicator," Falih said. "We are looking at inventories. We look at the fundamentals we can control."

Iranian oil minister Bijan Zanganeh, however, said it was his understanding that all OPEC members were seeking an ideal price range of $55-$60/b.

"What we have seen so far indicates that Saudis are keen on seeing an upward trend in the prices," he said before the OPEC meeting Thursday morning.

US SHALE NOT A WORRY

Skepticism over the resilience of US shale oil, with some projections foreseeing its growth of 1 million b/d this year or more, appeared to convince several OPEC ministers that deeper cuts were unnecessary.

Falih said such projections were "ambitious and bullish assumptions" and that "I personally think [they are] too high, so it is likely [the global market] will be balanced earlier than later."

He said he was not worried that US shale growth would undo the impact of the OPEC/non-OPEC cuts, saying the barrels would be needed to offset declines in legacy field declines.

"I don't see shale in any way derailing what we are doing," Falih said. "The market is big enough to absorb the increased production of shale."

The sentiments were echoed by UAE energy minister Suhail al-Mazrouei, who said: "I don't believe that [US shale producers] are able to increase production by 1 million b/d next year."

However, Falih acknowledged that there are "many variables" in the oil market and that the producer group would "adjust to the circumstances as they may develop."

The original deal, which was set to expire in June, failed to get oil inventories down to the five-year average, as OPEC has said was the goal.

But ministers were confident that continued cuts would allow them to get the job done by the end of the year, particularly with a strong stock draw forecast by many analysts in the third quarter.

That the deal is meant to run through March 2018, at least on paper, is designed to avoid the typical season stock build in the first quarter, according to ministers.

"OPEC does want backwardation, to elevate the front of the market but it's not going to be possible until they reduce the surplus stocks," said Gary Ross, global head of oil for PIRA Energy, an analytics unit of S&P Global Platts. "That process has begun but it's a slow process. It should accelerate as we go into the peak run period during June, July, and August."

Novak said the output cut agreement had gone a long way to stabilizing what had been a volatile market before it went into force in January.

Prices are "at a good level now between $50-$55/b," Novak said. "The market is a market, which fluctuates constantly. The most important is that the volatility is much lower than it was before the joint efforts."