The Cambridge Security Initiative

RUSSIA 'CONCEDES' ON WEAK OIL DEAL BUT PRICES STILL DROP

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Russia will soon abandon this month's historic OPEC+ deal to cut oil production by 9.7 million barrels per day (mb/d), a feeble attempt to stabilise prices after the Russian–Saudi supply war and COVID-19 lockdowns sent prices and demand plummeting almost simultaneously. The agreed cuts are far lower than needed to stabilise prices. And the Russian state's budget dependence on energy and dubious record on past compliance with much smaller cuts point to 'concessions' of slashing a quarter of daily output not being what they seem, with condensates excluded from calculations. Not that Russia can easily cut production anyway, but the real test for the deal comes next month, when COVID-19 lockdowns should start to ease and energy demand to rise (though from a collapsed starting point).

OPEC+ stressed the unprecedented reductions, which could roughly double if non-OPEC producers make voluntary, demand-driven 'cuts'. However, the pandemic has so collapsed global demand—down 35 mb/d (from an estimated consumption of 94.5 mb/d)—that even those additional voluntary cuts would fall short. So deeper production cuts are coming, yet global storage capacity is only weeks away from its limit; this will again press OPEC+ to act.

Letting non-member Russia have a say over OPEC decisions has given the country major influence over global energy. Especially since the United States started imposing sanctions in 2014 over the invasion of Ukraine, a key Russian aim has been to neutralise the U.S. shale oil and gas threat. Yet, Russia is spinning its signing of the OPEC+ deal as saving over two million U.S. jobs to show how indispensable and reasonable a partner it can be. And it is true that for now, at least, the shaky deal keeps U.S. shale cuts at 1.8 mb/d, not an expected 3.5 mb/d.

The intended damage is done. Russian delays in agreeing to OPEC+ cuts ensured a price war with Saudi Arabia even as COVID-19 collapsed global demand. Russia absorbed just enough economic pain to put U.S. shale "on life support", then 'conceded' to deeper cuts than the ones it had rejected last month. America will soon be unable to undercut Russian energy prices to supply European allies looking to diversify—a major geopolitical win for the Kremlin.

OUTLOOK

In the near term, Russia's economic pain will worsen, with an expected 87 per cent drop in oil export tax revenues next month. Collapse of foreign direct investment in Q1 2020 by 98 per cent compared to this time last year (£157.5 million versus £8 billion), plus investor capital flight of

£940 million, are only adding to Russia's financial troubles and may shift state spending priorities, precisely at a time when Russia's health care system is already struggling to cope with COVID-19.

The OPEC+ deal slowed the crash of oil prices for only a few weeks. The timelines of lifting lockdowns and the number of bankruptcies worldwide will be key indicators of how long this weak deal will last. The catastrophic combined impact on prices of the Russian–Saudi oil war and the pandemic also shows us what 'peak demand' will soon look like for hydrocarbon producers as the world moves to renewables in the medium term.