

OPEC's supply cuts pre-empt economic weakness

Published 6 April 2023

Aneeka Gupta

Director, Macroeconomic Research, WisdomTree Europe

The Organisation of Petroleum Exporting Countries and its partners (OPEC+) producers surprised the market with a decision on Sunday 2 April 2023 to lower production limits by more than 1mn barrels per day (bpd) from May through the end of 2023. This decision was announced ahead of the OPEC+ Joint Ministerial Monitoring Committee (JMMC) meeting scheduled on 3 April and was contrary to market expectations that the committee would keep policy unchanged. Over the prior week, OPEC+ ministers were giving public assurances that they would stick to their production targets for the entire year. This cut tells us that OPEC+ is pre-empting weaker demand into the year and was looking to shore up the market.

Source: OPEC, WisdomTree as of 2 April 2023.

Historical performance is not an indication of future performance and any investments may go down in value.

OPEC+ announcement may have caught speculators by surprise

It is evident Sunday's decision caught the market by surprise evident from the commitment of trader's report which showed net speculative positioning in Brent crude oil futures at -44k contracts were 146% below the 5-year average. Sentiment on the crude oil market had been weak prior to the decision.

Source: Commodity Futures Trading Commission, WisdomTree as of 28 March 2023.

Historical performance is not an indication of future performance and any investments may go down in value.

Demand outlook remains soft amidst weaker economic backdrop

OPEC has been markedly dovish on oil demand for some time relative to other forecasters such as the Energy Information Administration (EIA). This cut helps solve the disparity that existed between OPEC and the EIA. OPEC expects oil demand to grow by around 2mn bpd in 2023. A significant portion of this growth (nearly 710,000bpd) is reliant on Chinese oil demand¹. Given that such a large amount of demand hinges on a single economy poses a risk to the demand outlook as the pace of China's recovery post re-opening has not been as robust as previously anticipated. At the same time, tightening credit conditions owing to the recent banking crisis is also likely to weigh on growth forecasts in the rest of the developed world. Global Purchasing Managers Indices (PMI) indicators suggest manufacturing activity has contracted since September 2022.

Supply outlook will be driven by new OPEC+ cuts

Since Russia has been producing less than its notional limit, the reduction on actual production will be less than 1mn bpd. But with Saudi Arabia committing to voluntary reduction of 500,000bpd we would expect the overall decline in OPEC supply to be around 900,000bpd by the beginning of May 2023. Assuming OPEC production holding at the recent 28.9mn bpd for April, our balances would point to an equilibrium in Q2 and a return to a deficit in Q3 and Q4. This deficit is largely a function of OPEC+ cuts as opposed to stronger demand globally.

The front end of the Brent crude oil futures curve remains in backwardation with a roll yield of +0.4%.

Source: Bloomberg, WisdomTree as of 5 April 2023.

Historical performance is not an indication of future performance and any investments may go down in value.

OPEC+ producers can also cut without the fear that they will lose significant market share to non-OPEC members. Previously, OPEC+ would be reluctant to let prices rise too high, as it would incentivise a supply response from US producers. However, US producers today appear more focussed on capital discipline and maximizing shareholder returns. The US also has limited capacity to plug the shortfall created by OPEC+ cuts owing to last year's unprecedented release from strategic US oil reserves (now at a 40-year low).

Conclusion

In the short term, OPEC production cuts are almost always supportive evident from the recent price reaction Brent crude oil prices have risen (+6.54%²). However, over the medium term, the price response to cuts have been more mixed as they do tend to signal underlying weakness in the supply/demand balance. Either OPEC countries are expecting demand to be significantly weaker or doubt oil production in Russia will decline as sharply as forecasted.

So, with speculative positioning at currently low levels alongside further inventory draws expected later in the year, the risks are tilted towards the upside for crude oil prices. However, given the uncertainty in the macro environment, we expect the upside in prices to be capped at about US\$90 per barrel.

1 OPEC - The Organisation of Petroleum Exporting Countries

2 Bloomberg from 31 March 2023 to 5 April 2023

Related blogs

[+ OPEC+ throws fuels on the flame of the global energy crisis](#)

[+ What's Hot: Is it all bears from here for oil prices?](#)

Related products

[+ WisdomTree WTI Crude Oil \(CRUD\)](#)

- + [WisdomTree Brent Crude Oil \(BRNT\)](#)
- + [WisdomTree Brent Crude Oil 2x Daily Leveraged \(LBRT\)](#)
- + [WisdomTree Energy \(AIGE\)](#)
- + [WisdomTree WTI Crude Oil 2x Daily Leveraged \(LOIL/OIL2\)](#)
- + [WisdomTree WTI Crude Oil 3x Daily Leveraged \(3OIL\)](#)
- + [WisdomTree Bloomberg WTI Crude Oil \(WTID\)](#)
- + [WisdomTree Brent Crude Oil - GBP Daily Hedged \(PBRT\)](#)

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.