What's Hot: OPEC+ poised to rollover production cuts and keep oil futures in backwardation

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Nitesh Shah
Head of Commodities and Macroeconomic Research, WisdomTree Europe

Wichtige Erkenntnisse

- We expect OPEC+ to roll over existing voluntary supply cuts.
- A focus on compliance and correcting past over-production will be sharpened.
- Even if spot oil prices continue to range-trade, rolling oil futures investments will be interesting because of the shape of the oil futures curves.

Three Organization of the Petroleum Exporting Countries (OPEC) meetings are to take place on Sunday 2nd June via videoconference. (1) involving OPEC ministers, (2) involving OPEC and its partner countries (jointly OPEC+) and (3) involving the group's Joint Ministerial Monitoring Committee (JMMC). These are meetings where the member states decide on their next policy move.

The meetings were originally supposed to take place on Saturday 1st June in Vienna. The shift to a set of virtual meeting indicates that there is already broad agreement between members and the formalities could be easily executed via a video call. We expect the existing voluntary supply cuts among a subset of eight member/partners amounting to 2.2 million barrels a day that were due to expire at the end of June will to be rolled over until the end of the year.

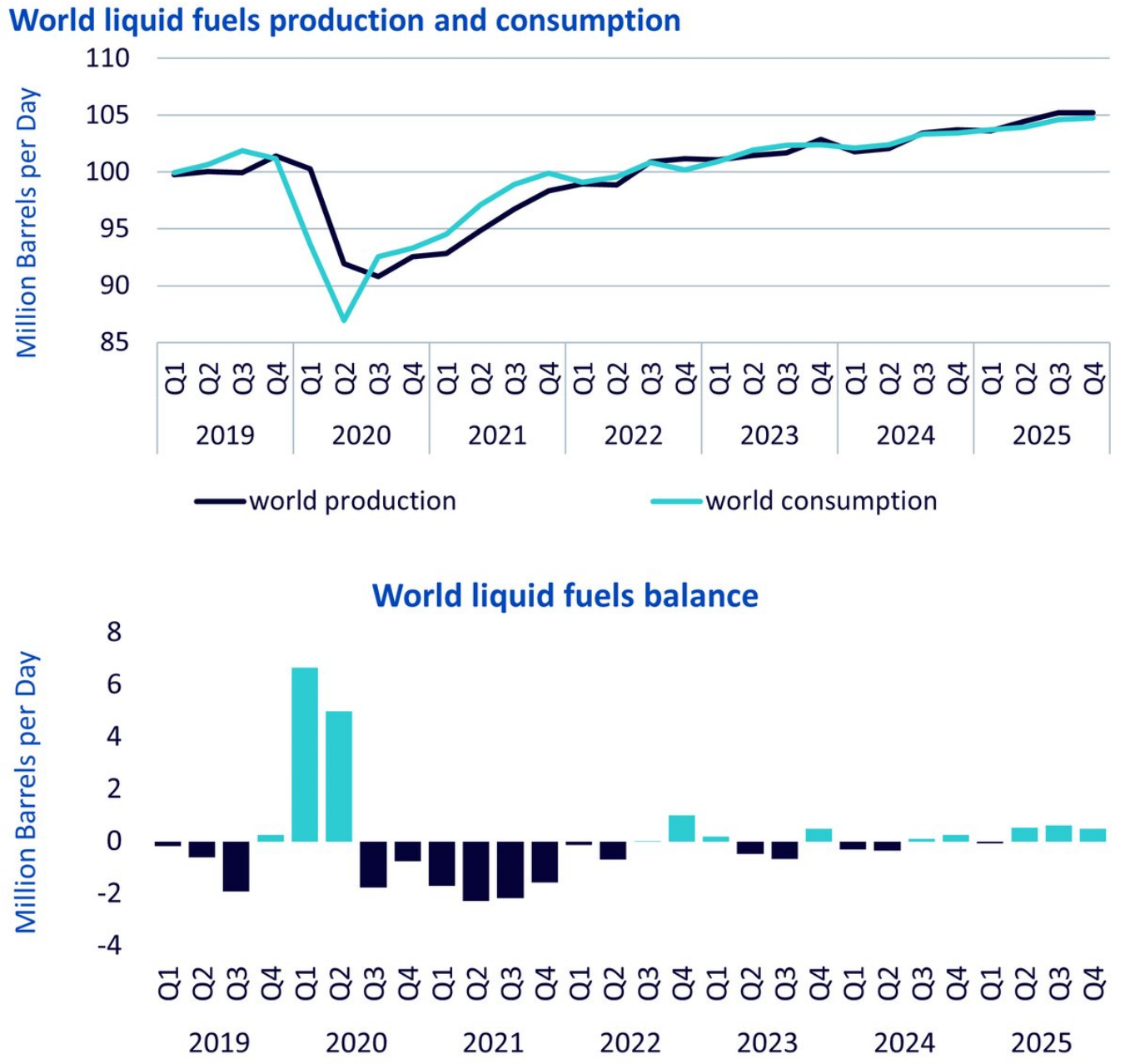
As the eight members participating in this voluntary supply cut are part of the JMMC, we could get an announcement from that committee's meeting instead the full OPEC+ meeting.

While most of the market focus will be on the voluntary supply cuts, OPEC+ is increasingly trying to focus on correcting prior non-compliance. Iraq and Kazakhstan, the group's biggest overproducers this year, has issued detailed programmes outlining how they plan to compensate[1], while Russia also acknowledged it had exceeded its OPEC+ target for April 2024 and said it would soon submit a plan to the OPEC secretariat detailing how it will make up it.

Market balance to be maintained

Despite the International Energy Agency and US Energy Information Administration softening their oil demand growth forecasts, we believe OPEC+ voluntary supply cuts and the compensation plans should

be enough to keep the liquid fuels markets broadly in balance for the remainder of this year. Although we expect oil supply growth from US, Canada, Brazil and Guyana to water down the cartel's efforts to tighten the oil markets significantly. OPEC+ needs to maintain a commitment to production restraint, even it means give more market share to non-OPEC+ competitors.



Source: WisdomTree, Energy Information Administration. May 2024. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

Range-trading likely to continue

Brent oil prices left the $90/barrel trading handle in the first half of April 2024 and has not returned since. OPEC's announcement that it will have a virtual instead of a physical meeting – which has been interpreted as a 'rubber-stamping' activity - provided a boost to oil prices in recent days with Brent bouncing from $80.72 on 24th May to $84.94 at the time of writing on 29th May 2024. Should there be no new surprises in the meeting, we could see oil continue to trade in the relatively tight range of $75/bbl-$92/bbl that we have seen since the start of this year.

Backwardation keeps oil interesting

Does range trading mean that investing in oil has become uninteresting? Not if you are investing via a rolling futures strategy. While many people focus on whether OPEC+s activity will move spot oils prices, we believe the more interesting thing is what their actions have done to the shape of the oil futures curves. Their supply restraints have kept both WTI and Brent futures curves in a state of backwardation, where prompt month deliveries cost more than deliveries further into the future. Backwardation is a source of positive returns for rolling-futures investors. Through the passage of time, as futures prices approaches the spot price, its price should rise (so long as the curve shape does not change). We call this a roll gain, which is a positive source of return for a rolling futures strategy investor.

As an illustration, the chart below shows that spot Brent oil prices, after rising sharply in the first half of 2022, gave back a lot of gains and then traded in a tight range for most of 2023 and 2024 to date, with prices only marginally up in the timeframe. Contrast that with a rolling futures strategy (firstly ignoring collateral returns). Due to the backwardation structure of Brent oil futures curves, a rolling futures strategy has been able to hold onto the early 2022 gains. Investors accessing a rolling futures strategy with a fully collateralised position should also receive a collateral yield. That further boosts their return in the positive interest rate environment that we have been in over the past few years.



Source: WisdomTree, Bloomberg. 03/01/2022 – 29/05/2024. Sprot proxy = front month future prices (not incorporating rolls). Rolling futures = Bloomberg Commodity Brent Oil Subindex Excess Return. Rolling futures with collateral return = Bloomberg Commodity Brent Oil Subindex Total Return. All data has been indexed to 100 on 03/01/2022. **Historical performance is not an indication of future performance and any investments may go down in value.**

So long as the oil futures curve remains in state of backwardation, even range-trading spot oil prices could mean that a rolling futures oil investment could be attractive.

We believe that OPEC+ is committed to keeping the oil markets in balance and by extension, keeping the oil futures curves in a state of backwardation. This weekend's meeting should confirm this commitment.

Sources

[1] https://www.opec.org/opec_web/en/press_room/7329.htm

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