What’s Hot: Oil too low for OPEC+’s comfort

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WTI and Brent oil dropped below US70/bbl and US75/bbl respectively for the first time since March 2023. Notably oil is trading lower today (04/05/2023) than before the Organization of the Petroleum Exporting Countries and its partner countries’ (OPEC+) intervention announced on Sunday 2 April. When OPEC+ announced its cut of 1.66 million barrels per day, the oil markets rose 10% within a space of a week, but prices have been slipping since then.

Oil markets are pessimistic

Markets seem to be hyper-focused on the effects of monetary tightening on future oil demand. Hence the pessimism in oil markets. Speculative positioning in Brent and WTI is depressed with Brent net short and WTI positioning more than 1 standard deviation below 5-year average.

Source: Bloomberg, April 2018 – April 2023

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

The Bank of England (BOE) shares the US Federal Reserve’s focus on getting inflation back to a range around 2% but, during 2022, inflation in the UK spiked to roughly 11.5% - an overshoot of 9.5%. The rate of inflation is likely to drop smartly but Trevor expects to see more of these episodes with inflation spiking and then falling back, a phenomenon he calls “Spike-flation”.

Inventory draws don’t support this level of pessimism

The hard data doesn’t support such level of pessimism. US oil inventory is declining at a rate stronger than seasonal trends would normally dictate and preliminary data for Europe and Japan indicate sizable inventory declines1. In fact, we expect production deficits to continue to eat into inventory for the rest of the year.

Source: Bloomberg, May 2018 – May 2023

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Fiscal breakevens explain OPEC+’s motivations

We believe OPEC+ could follow with another intervention as the group will be disappointed with current prices. Even though the cartel states its purpose of existence is to balance oil markets, the reality is, it is more focused on maintaining relatively high oil prices. Many governments of OPEC+ nations are highly reliant on oil revenues to finance their expenditures. Low oil prices act as a constraint on social expenditure. In fact, the fiscal breakevens – the price of oil needed for governments to balance their expenditures with their revenue - for many OPEC+ countries are significantly higher than where oil is trading today. Oil is currently trading below Saudi Arabia's estimated fiscal breakeven $78.17/bbl, and that should sharpen the focus of the largest OPEC member on driving prices higher. Most OPEC+ nations do not expect oil prices to reach their fiscal breakevens as that would choke off significant amount of demand. But, as a group have become comfortable with oil trading at close to US$90/bbl. That, we believe, will motivate the OPEC+ group to intervene again at its June 4th meeting.

Source: S&P Global, International Monetary Fund, January 2023. Historical performance is not an indication of future performance and any investments may go down in value.

Sources: 1 https://www.iea.org/reports/oil-market-report-april-2023

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